

National
Economic and
Social Council

An Chomhairle
Náisiúnta Eacnamaíoch
agus Sóisialach

Economic and Social Policy 1981

Aims and Recommendations

No. 62

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NATIONAL ECONOMIC AND SOCIAL COUNCIL CONSTITUTION AND TERMS OF REFERENCE

1. The main task of the National Economic and Social Council shall be to provide a forum for discussion of the principles relating to the efficient development of the national economy and the achievement of social justice, and to advise the Government, through the Taoiseach on their application. The Council shall have regard, *inter alia*, to:
 - (i) the realisation of the highest possible levels of employment at adequate reward
 - (ii) the attainment of the highest sustainable rate of economic growth.
 - (iii) the fair and equitable distribution of the income and wealth of the nation,
 - (iv) reasonable price stability and long-term equilibrium in the balance of payments,
 - (v) the balanced development of all regions in the country, and
 - (vi) the social implications of economic growth, including the need to protect the environment.

2. The Council may consider such matters either on its own initiative or at the request of the Government.

3. Members of the Government shall be entitled to attend the Council's meetings. The Council may at any time present its views to the Government, on matters within its terms of reference. Any reports which the Council may produce shall be submitted to the Government and, together with any comments which the Government may then make thereon, shall be laid before each House of the Oireachtas and published.

4. The membership of the Council shall comprise a Chairman appointed by the Government in consultation with the interests represented on the Council,
Ten persons nominated by the Confederation of Irish Industry and the Irish Employers' Confederation,

Ten persons nominated by the Irish Congress of Trade Unions,
Ten other persons appointed by the Government, and
Six persons representing Government Departments comprising one representative each from the Departments of Finance, Agriculture, Industry, Commerce and Tourism, Labour and Environment and one person representing the Departments of Health and Social Welfare.

Any other Government Department shall have the right of audience at Council meetings if warranted by the Council's agenda, subject to the right of the Chairman to regulate the numbers attending.

5. The term of office of members shall be for three years renewable. Casual vacancies shall be filled by the Government or by the nominating body as appropriate. Members filling casual vacancies may hold office until the expiry of the other members' current term of office and their membership shall then be renewable on the same basis as that of other members.

6. The Council shall have its own Secretariat subject to the approval of the Taoiseach in regard to numbers, remuneration and conditions of service.

7. The Council shall regulate its own procedure.

NATIONAL ECONOMIC AND SOCIAL COUNCIL

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BUDGET, JULY 1981

On the 21 July 1981 the Government introduced their Budget. The main conclusions and recommendations to this report were developed on the basis of information available up to mid-July 1981, i.e. before the introduction of the July Budget. The statistical material in the report was subsequently revised in a number of key places to take account of the latest information provided through the Budget (July) 1981. It is, however, the view of the Council that the conclusions and recommendations in this report are still valid, after the July 1981 Budget.

SUMMARY

Chapter 1: Economic Developments, 1979 and 1980

In 1979 the rate of growth of Gross Domestic Product (GDP) fell to 1.9 per cent, substantially less than the EEC average of 3.5 per cent. The relative decline in output growth was largely attributable to the decline in agricultural output. An increase in both consumption and investment was achieved at the expense of a sizeable increase in the current balance of payments deficit which increased from 3.2 per cent of GNP in 1978 to 10.1 per cent in 1979.

In 1980 GDP grew by an estimated 2.1 per cent while the EEC average was 1.2 per cent. Given an unfavourable international environment, there was a slowing of industrial export growth, although overall export growth was aided by a recovery in agricultural exports. During 1979 and 1980 Ireland's terms of trade deteriorated sharply, with rapidly rising oil prices and slowly rising agricultural prices. The effect has been that the real value of goods and services available to the community, as measured by Gross National Product (GNP) adjusted for the terms of trade, declined by 2.4 per cent in 1980.

Total employment is estimated to have fallen by up to ten thousand between April 1980 and April 1981, with unemployment increasing by about 30 thousand. The unemployment rate, including school-leavers seeking jobs for the first time, is estimated at 9.3 per cent in April 1981.

In agriculture, during 1979 and 1980 the volume of gross output declined by about one per cent while real family-farm incomes fell by about 40 per cent. There was a considerable reduction in the cattle herd. In 1980 the cow herd declined by 5 per cent and there was little indication that the level of replacement stock was sufficient to compensate for the reduction in numbers.

In 1980, manufacturing industry experienced a fall in output of 2 per cent, while employment declined by 1.1 per cent. Between December 1979 and December 1980, the numbers employed declined by 9,400, more than cancelling out the employment gains of 1979.

Unit labour costs in Ireland, as measured by European Commission statistics, increased by 5.3 per cent relative to the main industrialised countries in 1979, and by a further 7 per cent in 1980. The deterioration in unit labour costs relative to the other participants in the European Monetary System (EMS) was particularly marked in the latter year. The

rate of inflation was 18.2 per cent in 1980, in contrast to an EEC average of 12.2 per cent for the period.

The current account deficit of the balance of payments was equal to 10.1 per cent of GNP in 1979 and 8.4 per cent in 1980. The financing of these large deficits has been achieved largely through the expansion of public sector borrowing abroad.

Government expenditure relative to GNP increased by 8.6 percentage points, from 48.8 per cent in 1978 to 56.9 per cent in 1980. The expansion of current expenditure accounted for 6 percentage points. That part of the increase due to increased expenditure on goods and services is due, primarily, to the rise in price of such goods and services, relative to the prices of other goods—a price rise due in part at least, to relative wage movements between public and private sectors.

Tax revenue did not match the increase in Government current expenditure and the result was an increasing current budget deficit. The current budget deficit was equal to 7.3 per cent of GNP in 1979 and 6.6 per cent in 1980. The scale of these budget deficits and the expansion of Government capital expenditure have resulted in substantial increases in the borrowing requirement of the Exchequer. The Exchequer borrowing requirement in 1980 amounted to £1,217 million, 14.6 per cent of GNP, compared with 14.0 per cent of GNP in 1979, and 13.0 per cent in 1978. The more broadly defined public sector borrowing requirement, which comprises the borrowing of the Exchequer, State-sponsored bodies and local authorities amounted to 18.9 per cent of GNP in 1980.

An aspect of fiscal policies during 1979 and 1980 has been the increasing scale of error in budgetary forecasts. Estimates in the budget statements of 1979 and 1980 suggested that the Exchequer borrowing requirement would amount to 10.5 per cent in both years, while the actual outturns were 14.0 per cent and 14.6 per cent of GNP, respectively. The actual current budget deficit in 1979 was 80 per cent greater than forecast in the 1979 Budget, while the 1980 outturn was 50 per cent greater than the forecast in the 1980 Budget.

Chapter 2: Economic Outlook: 1981 and 1982

The immediate outlook for the OECD countries is for slow recovery from the trough of the recession, with the rate of growth of output unlikely to reach its 1979 levels before late 1982. Of particular importance to the external environment for the Irish economy are (i) the expectation of limited expansion of the country's main export markets and (ii) the general easing of inflationary pressures in Ireland's main trading partners, most notably the United Kingdom.

A comparison of the present experience with economic events in 1973-76 suggests the European Community is likely to suffer less output

decline and inflation in the present recession. In Ireland, however, the outlook for agricultural output and the constraints on domestic policies imposed by the budgetary position and the balance of payments suggest that the economy will fare less well *vis-a-vis* the Community than was the case in 1973-75. Agricultural exports are likely to fall in volume terms this year. Industrial export growth should continue to be aided by the coming "on stream" of new overseas industrial projects. The total value of exports is expected to increase by 16.5 per cent, composed of a price increase of 15 per cent and a volume increase of 1.25 per cent.

The outlook for selected main economic indicators for 1981 compared to 1980 is as follows:

	1980	1981
Increase in GDP	2%	2%
Increase in GNP, adjusted for the terms of trade	-2.5%	-1%
Deficit on current account of the balance of payments	£700m	£1,375m
— as % of GNP	8.4%	13.8%
Official external debt at end-year	£3 billion	£4.3 billion
Current budget deficit	£547m	£789m
Annual inflation	18.2%	20%

The forecast current budget deficit, at 7.9 per cent of GNP, is the largest ever recorded and the forecast balance of payments deficit on current accounts at 13.8 per cent of GNP is the largest recorded since 1951. The deficit on current account will be largely financed through official external borrowing by the Exchequer and by the State-sponsored bodies. New official external borrowings will amount to about £1.15 billion in 1981. The end-year external debt is likely to reach £4.3 billion—a 40 per cent increase during the year. Given the output environment, total employment is unlikely to show any significant increase in the twelve months from April 1981 to April 1982. In the absence of employment growth, the unemployment rate in April 1982 is likely to be about 10.5 per cent including school-leavers seeking their first job.¹

The outlook for 1982 is examined on the assumption of a "neutral" policy stance by the Government, involving no change in the volume of Government expenditure and no change in the real value of social welfare payments, income tax allowances and specific taxes. The external environment facing the Irish economy in 1982 appears likely

¹In the present report, the definition of unemployment follows that of the Labour Force Surveys.

to be characterised by a somewhat improved demand situation in export markets and relatively slow increases in traded goods prices. The expansion in exports and a recovery in private sector investment will be the chief factors contributing to output growth during the year. Gross Domestic Product is expected to increase by 2.5 per cent, with GNP increasing by about one percentage point less, due to the increasing interest rate burden resulting from the increase in external indebtedness. The balance of payments deficit on current account should be of the order of £1,375 million, over 13 per cent of GNP.

Chapter 3: Review of Social Policy

A number of significant developments occurred in the area of social policy in the past year, including the non-pay terms of the Second National Understanding and the designation of 1981 as the International Year of Disabled Persons.

There is likely to be a significant increase in real terms in public capital expenditure on housing, education and health services in 1981. Real increases in current expenditure on housing, education and social welfare are also likely in 1981, with a significant reduction in real current expenditure on health services.

The recently announced increases in subsidies to home purchasers will ease the burden of repayments in the early years of a mortgage and assist those who would otherwise be dependent on local authority housing to purchase their own homes. However, the overall direction of housing subsidies is regressive. The distributive impact of the policy of sales of local authority dwellings and of the reduction in the level of subsidy of local authority tenants in favour of house purchasers should be kept under review.

The White Paper on Educational Development suggests that substantial increases in real levels of expenditure will be necessary to cater for increased enrolments over the coming decade. It is regrettable that the White Paper did not address the question of priorities for achieving equality of opportunity in education.

In view of the projected reduction in real expenditure on health services, it is important that the burden of adjustment does not fall on community services such as home helps, meals-on-wheels and grants to voluntary organisations, which are vulnerable because their level of provision is determined by administrative decision rather than statutory entitlement.

The failure to maintain the real value of payments to child dependants of social welfare recipients is regrettable. Recent delays in payment of social welfare payments are a matter of grave concern and the question of decentralising payments to increase the flexibility of the system should be examined.

The distributive effects of the tax system must be taken into account in assessing progress towards achieving social policy objectives. As a result of tax changes, the disposable income of those on high incomes has increased substantially relative to average earnings.

The average levels of payment to the unemployed are low relative to average earnings and, of themselves, are unlikely to act as a disincentive to gainful employment. The adequacy of payments to the long-term unemployed is questionable. The burden of unemployment is particularly heavy on young people and on older and less skilled workers. Recent measures to improve the employment opportunities of residents of the inner-city of Dublin are to be welcomed.

Chapter 4: Strategic Problems for Economic and Social Development

This chapter identifies the main problems which must be overcome if economic and social objectives are to be achieved. These problems are related to:

- the balance of payments
- inflation and the exchange rate
- incomes and employment
- demographic structure
- redistribution.

The balance of payments deficit on current account indicates the amount which the country is spending in excess of its income. The size of the balance of payments deficit is now a fundamental constraint to policy. The deficit is, in large part, the result of expansionary fiscal policy and the growth of nominal incomes in excess of output growth. The net external indebtedness of the State and State-sponsored bodies more than doubled between December 1978 and December 1980. The repayment of the debt incurred will amount to an estimated £460 per employed person in 1981, and could rise to £820 by 1983.

The larger the country's net external indebtedness, the more vulnerable the economy is to outside factors, such as trends in world trade and fluctuations in the availability and cost of finance. If the adjustment of living standards to available resources is not brought about by planned measures the adjustment will be forced upon the community through the action of creditors and/or a forced devaluation of the Irish pound within the EMS.

In March 1979 Ireland joined the European Monetary System. It was argued, at the time, that the link to a strong currency regime would lead to a convergence of the Irish inflation rate to the generally lower rates obtaining in the continental EEC countries. This convergence of inflation rates has not occurred. The constraint of a rising balance of

payments deficit has been temporarily removed through recourse to external borrowing. Expansionary fiscal policy is relatively ineffective in reducing unemployment because a high proportion of the increased incomes is spent on imports, thus producing a significant deterioration in the current balance of payments. The present high levels of Government foreign borrowing and the increasing burden of interest payments on outstanding debt leave no scope for such expansionary policies.

Import controls and devaluation are inappropriate to Ireland's specific circumstances. Moderation in the growth of real incomes would provide a significant stimulus to employment through its effects on the competitiveness of the exposed sector and also through the effect on the demand for imports.

The Irish population has a high dependency ratio. It is to be expected that the proportion of national output devoted to social expenditure would be high by European standards. The growth of the country's labour force is expected to continue over the coming decade. The provision of employment for the increased numbers seeking work will constitute one of the principal challenges to economic and social policy.

The successful implementation of economic policies will require that they operate and are seen to operate with due regard to the reduction of inequalities of income and wealth. The principal means of reducing inequalities are the tax and transfer systems. For example, revenue could be raised in a more progressive fashion if the value of reliefs from income tax were restricted to the standard rate equivalent, rather than the marginal rate.

Chapter 5: Aims and Recommendations

The main problems now facing the Irish economy are unemployment, the high balance of payments deficit, the high current budget deficit, the high rate of inflation and the high rate of unit labour cost increases. These problems are similar to those which faced the Irish economy in 1980 but they are now more severe. There is an urgent need for policies to tackle these problems effectively.

The elimination of the current budget deficit would ease the balance of payments deficit which is at present a severe constraint on other policy measures. The Council recommends a target of three years for the planned elimination of the current budget deficit. With the existing tax system a higher rate of economic growth will not lead to the automatic elimination of the deficit.

The potential for restoring balance through the curtailment of public expenditure is limited. Any attempt at blanket reductions in public expenditure programmes without regard to the redistributive and employment consequences, and in particular to the likely impact on the most vulnerable groups in the community, would be undesirable. The

question of widening the tax base, in particular through greater use of capital taxation, should be considered from the perspective of a more equitable distribution of resources as well as the elimination of the current budget deficit.

Depending on the progress made in reducing the current budget deficit the Council believes that productive capital expenditure may be allowed to increase in real terms on a selective basis. There is a valid case for the financing of a deficit in the public capital programme by foreign borrowing when the resulting investments provide a return sufficient to meet interest charges and capital repayments. The Council recommends that all public investments should be rigorously evaluated against this criterion.

The future growth of the economy is dependent on the success of the exposed sector in home and export markets. This success is primarily determined by levels prevailing for income, by productivity and also, of course, by such factors as management practices and marketing. Using the measure of unit wage costs Ireland has incurred a significant loss in cost competitiveness relative to the main industrialised countries since entry to the EMS. This loss of competitiveness in home and export markets has led and will continue to lead to a loss in employment.

The Council recommends the adoption of an incomes pause as an essential element in aiding the restoration of economic competitiveness in the short term. On current trends, an incomes pause of eighteen months duration would be required to offset the decline in competitiveness which has occurred since Ireland's entry to the EMS. In this context the Council recommends that all incomes, with the exception of agricultural incomes, and not just employee incomes should be subject to a pay pause for eighteen months or at the very least for the longest sustainable period leading to eighteen months following the expiry of the Second National Understanding. Following the restoration of previous competitive levels the Council recommends that income increases should not exceed what the exposed sector will bear.

The short-term deflationary effects of a pay pause and the elimination of current budget deficit will be mitigated to a large extent by the openness of the economy. The deflationary impact will be seen primarily in a drop in the demand for imports and an increase in the volume of exports consequent upon the improvement in competitiveness. Any short-term adverse effects on output and employment will quickly be reversed as the economy benefits from the improved state of the public finances and the gain in competitiveness.

The main conclusions of this report were formulated before the Budget of 21 July 1981. Notwithstanding the effects of that Budget the Council believes that the analysis and recommendations in this report are still valid.

CHAPTER 1¹

ECONOMIC DEVELOPMENTS 1979 AND 1980²

Output

1.1 The period 1970-76 saw Ireland's Gross Domestic Product (GDP) expanding at an average annual rate of 3.6 per cent, compared with an EEC average of 3.1 per cent. Under the expansionary stimulus of Government expenditure and taxation policies and the favourable international environment, the pace of growth accelerated in 1977 and 1978, with output growth being more than double the EEC average (Table 1). Much of this growth can be attributed to the sustained expansion of exports which, aided by the inflow of new foreign firms, grew in volume terms at rates of 13.5 per cent and 12.7 per cent respectively, in these two years. Fixed investment also increased rapidly, with the share of GDP going to domestic fixed capital formation increasing from 23.9 per cent in 1976 to 28.2 per cent in 1978 (Table 2).

1.2 In 1979 the rate of growth of GDP fell to 1.9 per cent, less than one-third the growth rate of the preceding year, and substantially less than the EEC average of 3.5 per cent. Investment continued to expand rapidly, increasing in real terms by some 16 per cent, and attaining a remarkable 32.2 per cent share of GDP—the highest investment ratio in the European Community. The relative decline in output growth was largely attributable to the decline in agricultural output, with its associated effects on private consumption and exports. While industrial exports continued to expand rapidly in 1979, assisted by the continued expansion of the European economies, agricultural exports are estimated to have grown by a mere 4.6 per cent in nominal terms, and to have fallen by about 3 per cent in volume terms. The effects of declining agricultural output on income and consumption growth were partially

¹ Following discussions in the Economic Policy Committee, in the Social Policy Committee and in the Council, the successive drafts of this report were prepared by the Council secretariat assisted by John Blackwell and Sean Nolan. Mr Nolan, a graduate student at Yale University, drafted Chapters 1, 2 and Appendices 1, 2 and assisted with Chapter 4. Mr Blackwell drafted Appendix 3 and assisted with Chapter 4. A background paper on agriculture was prepared by Brendan Kearney of the Agricultural Institute.

² The cut-off point for the data which are used throughout the report is 31 July 1980.

offset by the continued stimulus provided by Government fiscal policies. Both public and private consumption expanded substantially, albeit at a slower rate than in 1978, and the total consumption share of GDP increased from 80.4 per cent to 82.9 per cent. The concurrence of an increasing consumption share and an increasing investment share was achieved at the expense of a sizeable increase in the current balance of payments deficit, with the excess of imports over exports increasing from 9 per cent of GDP in 1978 to 16.2 per cent in 1979.

1.3 By late 1979, the international economy had begun to move into recession, in part attributable to the effects of rising oil prices, which increased by 150 per cent in the eighteen months from December 1978. The rate of growth of output for the OECD area as a whole fell to 1.3 per cent for 1980, compared to an estimated 3.3 per cent the preceding year. Trade between the OECD countries, which include Ireland's chief export markets, declined markedly, with the rate of growth in volume of intra-OECD imports declining from 9.75 per cent in 1979 to 2 per cent in 1980. The weakening of Irish export markets produced a marked slowing in industrial export growth, although overall export growth was partially sustained by a recovery in agricultural exports. Despite the continued expansion of public sector investment, fixed capital formation in 1980 fell in real terms by an estimated 7.9 per cent, indicating a substantial decline in private sector investment. Private consumption in real terms declined by 1.2 per cent while public consumption expenditures increased by 4 per cent. Gross Domestic Product rose by an estimated 2.1 per cent in 1980, in comparison with an increase of 1.2 per cent for the European Community as a whole.

1.4 In a small economy such as Ireland, closely integrated into the international trading system, growth in average real incomes can occur in one of two ways. First, overall productivity may improve in the country, in the sense that the output of goods and services per person employed may increase. Second, the country's terms of trade can improve, in that the prices of the particular goods and services it exports increases relative to the prices of the goods it imports. A recent example of how terms of trade movements can improve incomes is provided by the experience of the OPEC countries, where real incomes have risen substantially due to the large oil price increases. Ireland's heavy reliance on international trade makes it particularly vulnerable to the influence of changes in the terms of trade. If Irish GNP is to measure appropriately the real value of goods and services available to the community in any year, it must be adjusted to allow for the effects of changes in the terms of trade. The effects of such adjustment may be either to increase or decrease GNP, depending on whether the terms of trade have moved

in Ireland's favour or not. While GNP increased by 6.3 per cent in real terms in 1978, GNP at constant prices adjusted for changes in the terms of trade increased by a further 1 per cent. During the last two years, however, Ireland's terms of trade have deteriorated sharply, with rapidly rising oil prices and slowly rising agricultural prices. Such was the extent of the deterioration that the real value of GNP declined by an estimated 2.4 per cent in 1980, despite an increase in the volume of GNP of 1.4 per cent.

Employment Trends

1.5 Ireland is experiencing a rapid growth in the size of the labour force, with the rate of growth averaging 1.6 per cent per annum in the years 1975-80. This rate of growth is over twice the EEC average, and represents a marked change in Ireland's demographic experience. Over the same period, the total numbers employed have expanded at a similarly rapid pace, increasing by 95,000 between April 1975 and April 1980. Employment growth of such a scale was remarkable in comparison with the experience of other EEC countries. Between 1975 and 1979, employment increased in Ireland by 7.2 per cent, compared to an EEC average of 1.3 per cent. Unemployment declined between April 1977 and April 1980, with the numbers unemployed falling by 15 thousand, while the unemployment rate fell from 7.6 per cent to 6.0 per cent.³ (Table 3)

1.6 The slow-down in output growth referred to in paragraphs 1.2 and 1.3 above was reflected in increasing unemployment. The numbers on the Live Register, seasonally adjusted, began to increase in the first quarter of 1980, and continued to increase in succeeding quarters. It is possible that total employment has fallen by up to 10 thousand between April 1980 and April 1981, with unemployment increasing by about 30 thousand. The unemployment⁴ rate is likely to have increased from 6 per cent to an estimated 8.3 per cent over the same period. If one is to allow for school-leavers seeking jobs for the first time, the unemployment rate in April 1981 is an estimated 9.3 per cent. (Table 5)

Agriculture

1.7 The down-turn which commenced in the agricultural economy in 1979, after four years of substantial growth in output and incomes, continued during 1980. Product prices were generally lower than in 1979, the increase in input costs accelerated, inflation was considerably higher,

³Unemployment as used above refers to the unemployment definition used in the Labour Force Surveys, and the labour force statistics revision of 19 December 1980.

⁴The unemployment rate referred to above uses the definition of unemployment used in the Labour Force Surveys.

and interest rates reached historically high levels. Adverse weather conditions made fodder conservation very difficult and seriously affected harvesting operations, cereal quality and production. Additionally, the increases granted in intervention prices in the EEC price review were not reflected in Irish farmgate prices. While intervention price levels were increased on average by about 4 per cent, the agricultural output price index in Ireland declined by 2.7 per cent, in contrast with an input price index increase of 14.5 per cent. (Table 4)

1.8 The year 1978 can be seen as a watershed in the agricultural economy, especially in relation to price/cost relationships, value of net output and real incomes. (Table 4) All of these indicators declined over the two succeeding years. In that period input costs increased by 29 per cent, volume of gross output declined by about 1 per cent while real family farm incomes have fallen by about 40 per cent.⁵ The decline in output had its origin particularly in contrasting developments in the beef and dairy sectors in the period 1975-1978. (Table 5) During these years milk supplies expanded rapidly, mainly due to higher yields per cow, associated in turn with increased use of concentrate following on an appreciable increase in the milk/concentrate price ratio. In the two years following 1978, delivery per cow was virtually static and so were milk supplies. Expansion in the dairy sector in the period 1975-78 was the primary factor in the substantial increase in farm output and incomes and probably camouflaged the relatively indifferent performance in some other sectors, notably cattle. Side by side with the moderate expansion in dairy cow numbers and milk yields, the beef cow herd has been in persistent decline.

1.9 One of the most significant features of the agricultural economy in 1980 was the considerable reduction in the cattle herd. (Table 27) Cattle stocks were about 419 thousand less at the end of 1980 than a year previously, which represented a considerable destocking. Several factors contributed to the decline in numbers including an anticipated fodder shortfall, the general economic situation in farming and disease eradication. The most serious aspect of the destocking process relates to the decline in cow numbers. At year end the cow herd had declined by 5 per cent and there was little indication that the level of replacement stock was sufficient to compensate for the reduction in cow numbers. Indeed the major source of the current decline in the breeding herd has been increased disposals rather than reduced drafting which is in contrast with the position in the period 1967-74.

⁵The decline in family farm incomes net of interest payments is likely to have been somewhat greater than this.

Manufacturing Industry

1.10 Irish manufacturing industry, assisted by the inflow of new foreign firms, experienced substantial growth in the years 1978 and 1979, with output growth averaging 6.8 per cent per annum, a figure substantially in excess of other EEC countries. Employment in manufacturing industry increased by 14,600 an annual average growth of 3.5 per cent. (Table 6) These growth trends were reversed in 1980, with output falling by 2 per cent, and manufacturing employment declining by 1.1 per cent.⁶ Between December 1979 and December 1980, the numbers employed declined by 9,400, more than cancelling out the employment gains of 1979.

1.11 The sectoral composition of Irish manufacturing industry has been undergoing systematic change throughout the 1970s, with traditional light consumer goods industries experiencing a relative decline. The causes of this structural change are to be found in the effects of freer trade, and the types of industry attracted to Ireland. The two years 1979 and 1980 have seen such tendencies continuing and indeed intensifying, with employment declining in textiles, clothing and footwear, paper and printing and wood products, while increasing in the chemicals and metals and engineering sectors. (Table 7)

Incomes and Competitiveness

1.12 After significant growth in real disposable personal income, averaging over 6 per cent per annum, in the three years 1977-79, the weakening economic situation in 1980 led to a fall in real disposable incomes of at least 2 per cent. The use of aggregate statistics hides the markedly different experiences of different groupings within the labour force. Workers in the transportable goods industries have seen their real pre-tax earnings increase by 14 per cent in the 4 years, 1977-80. (Table 8) Family farm income, although showing a notable increase in 1977, fell substantially in real terms in both 1979 and 1980, and by 1980 was 23 per cent lower than in 1976. Non-agricultural non-wage incomes—which include non-agricultural profits, professional earnings and rent—declined in real terms by about 13.5 per cent in 1980, having increased at an annual rate of 9.8 per cent during the preceding three years.

1.13 Comparisons of productivity and of movements in unit wage costs across international boundaries must be treated with caution, given the problems posed for such comparisons by differing industrial struc-

⁶The 1.1 per cent decline in employment is a decline in the annual average employment level while the 9,400 decline in absolute manufacturing employment is arrived at by comparing December 1980 with December 1979. The two figures are therefore not comparable.

tures, differing techniques of production, and the short-run variability of exchange rates. Problems of comparison are increased in a recessionary period, given that productivity will be strongly affected by the degree of capacity utilisation. Comparable statistics produced by the Commission of the European Community indicate that the cost competitiveness of Irish industry *vis-a-vis* other EMS countries has deteriorated substantially in recent years. (Table 9) In the years 1979 and 1980, the rate of growth of dollar unit labour costs in Ireland was markedly in excess of that of our major competitors, with the exception of the United Kingdom (UK), where the strong appreciation of sterling and the large decline of industrial output have produced a marked growth in unit labour costs. Unit labour costs in Ireland increased by 5.3 per cent relative to the average of the main industrialised countries in 1979, and by a further 7 per cent in 1980. The deterioration in unit labour costs relative to other participants in the European Monetary System was particularly marked in 1980, as only France experienced a significant increase in unit labour costs relative to the average of the industrialised countries, a 1.9 per cent relative increase in contrast with Ireland's experience of 7 per cent.

Foreign Trade and the Balance of Payments

1.14 Export growth in 1979 and 1980 has been strongly affected by the problems of the agricultural sector, and the onset of an international recession. Agricultural exports declined in volume terms in 1979, and although export volume increased significantly in 1980, it was chiefly attributable to the large-scale destocking in agriculture, which should lead to a weaker medium term export performance. The growth in the volume of industrial exports, having been extremely rapid in the period 1977-79, experienced a slowdown in 1980, largely as a result of weakening external demand conditions, but still recorded a volume increase of 7 per cent.

1.15 Despite the deterioration in Ireland's cost competitiveness in 1979 and 1980, Ireland's export share of developed countries' manufactured exports increased during these years, from 0.426 per cent in 1978 to 0.473 per cent in 1979 and 0.499 per cent in 1980. (Table 10) This improvement in export share is, however, largely attributable to the coming "onstream" of new foreign firms while there was a deterioration in the relative performance of established industry.

1.16 The home market orientation of much of "traditional" Irish industry suggests that the effects of declining competitiveness are most likely to be felt in increased import penetration. Imports of goods and services grew extremely rapidly in the years 1977-79, (Table 1), with

imports as a share of GDP increasing by 10 percentage points, from 60.7 per cent in 1977 to 70.7 per cent in 1979. While the import share of GDP is an extremely crude measure of import penetration, the scale of the movement was such that there can be little doubt that competing imports are increasing their market share—with a consequent loss in domestic output and employment. The volume of imports fell by an estimated 4.5 per cent in 1980 but much of this decline was due to declining demand for capital goods and intermediate inputs.

1.17 As a consequence of these movements in exports and imports, Ireland's balance of payments deteriorated substantially in 1979, with the trade deficit widening by some £600 million and the current account deficit increasing from £200 million in 1978 to £727 million in 1979. (Table 11) Despite the decline in the volume of imports in 1980, the adverse movement in the terms of trade, the increasing levels of interest payments on the external debt,⁷ and a decline in net receipts from the EEC combined to ensure that the current account deficit showed no significant improvement in nominal terms, although the deficit as a percentage share of GNP declined from 10.1 per cent in 1979 to 8.4 per cent in 1980. Financing of current account deficits of such magnitude has been achieved largely through the expansion of public sector borrowing abroad. Net official foreign borrowing by the Government and the State-sponsored bodies amounted to approximately £650 million in 1979, and £890 million in 1980.⁸

Inflation and the Exchange Rate

1.18 Prior to the emergence of the European Monetary System, Ireland's close trading and institutional links with the UK resulted in a situation where the movement of price indices and interest rates in Ireland were primarily determined by economic events in the UK. Ireland's fixed exchange rate *vis-a-vis* sterling, and Britain's role as the dominant trading partner meant that Ireland's inflation rate was largely outside the control of domestic policies and closely followed the UK rate; although indirect tax movements and other factors led to slight differentials. Free capital mobility between Ireland and the UK, in combination with the fixed exchange rate, ensured that Irish interest rates could not deviate significantly from the interest rates prevailing in London.

⁷ Interest payments on the external debt of the Exchequer and the State-sponsored bodies increased from Ir£141 million in 1979 to Ir£240 million in 1980. *Dail Debates*, 5 May 1981.

⁸ 1980 estimate is from Central Bank, *Quarterly Bulletin*, 1981(1). 1979 estimate is derived from Tables 25 and 27. As State-sponsored bodies data is derived from end-year balance sheets, the borrowing figure may include a revaluation effect arising from exchange rate movements.

1.19 The advent of the EMS, and Britain's non-participation in it, has partially transformed these relationships. Ireland is now a member of a quasi-fixed exchange rate system, while having a flexible exchange rate *vis-a-vis* her primary trading partner. Britain's role as the chief recipient of Ireland's exports and the main source of Irish imports means that Irish prices are under substantial pressure not only from Britain's price inflation, but also from the appreciation of sterling *vis-a-vis* the European currencies. Ireland's rate of price inflation, having closely followed that of the UK until 1979, was substantially in excess of Britain's inflation rate by the first quarter of 1981. The UK's recent experience of faster inflation and an appreciating currency *vis-a-vis* the continental European countries has contributed to a widening of the divergence between Ireland's inflation rate and the average for the European Community as a whole. (Table 12) In 1978, the percentage change in consumer prices in Ireland was 7.6 per cent, in comparison with an EEC average inflation rate of 7 per cent. The acceleration of international inflation that accompanied the oil price increases of 1979 and 1980 saw the EEC average rate of price increase amounting to 12.2 per cent in 1980⁹ while the Irish inflation rate increased even more rapidly to 18.2 per cent. (Table 12)¹⁰

1.20 Prior to EMS, the linkage of the Irish pound with sterling resulted in the continued depreciation of the Irish currency *vis-a-vis* the European economies throughout the 1970s, although the dollar value of the pound recovered significantly after 1976. Membership of the European Monetary System has resulted in the Irish exchange rate being linked with the European currencies, with only slight deviations in values being experienced in 1979 and 1980. (Table 13) Tight monetary policies in the UK in combination with the effects of North Sea oil on Britain's balance of payments have led to the marked appreciation of sterling relative to the EMS currencies. This resulted in a 20 per cent depreciation in the value of the Irish pound *vis-a-vis* sterling between March 1979 and the end of 1980. (Table 13) The competitive advantages afforded to Irish exports to the UK have, however, been partly offset by poor demand conditions in the UK and the deterioration in Irish competitiveness relative to other industrialised countries competing in the UK market.

1.21 Ireland's experience of high interest rates in 1979 and 1980 must be viewed against a background of relatively high interest rates in the

⁹ The unweighted average rate of price increase for the EMS member countries excluding Ireland was 10.2 per cent.

¹⁰ The effects of indirect tax changes on inflation rates means that international comparisons must be treated with some caution.

international economy as a whole, due to high inflation rates and the tightening of domestic monetary policies. Ireland's prime lending rate, 7.5 per cent in December 1977, increased to 15.5 per cent in June 1979, with a further increase to 18 per cent in April 1980. A substantial easing in interest rates occurred in the second half of the year, with the prime lending rate falling to 14 per cent in October 1980.

Public Sector Pay, Employment and Finances

1.22 The years 1979 and 1980 saw a substantial expansion of Government expenditure in both real and nominal terms, with the expansion of capital expenditure being particularly marked. (Table 14) Government outlays on the capital account increased by 65 per cent in nominal terms over the two years, with the rate of growth in volume terms being 9.6 per cent in 1979, and 13.3 per cent in 1980. Government current expenditure also grew substantially in real and nominal terms during these two years, with a volume growth of 3.3 per cent and 4.5 per cent respectively. (Table 14)

1.23 The experience of recent decades, both for Ireland and other countries, indicates that the share of public expenditure in GNP tends to increase over time. The causes for such an increase are examined in NESR Report No. 21;¹¹ among the factors influencing such a development are the increasing demand for publicly provided goods and services as articulated through the political system, the increased role of the State in influencing the distribution of income and the nature of the decision-making process in public sector activities. In the two-year period 1978-80, Government expenditure relative to GNP increased by 8.6 percentage points, from 48.8 per cent in 1978 to 56.9 per cent in 1980. (Table 15) The expansion of Government current expenditure accounted for 6 percentage points, with the residual being due to the increase in Government capital outlays.

1.24 A number of factors can be used to explain the large expansion in the Government current expenditure share of GNP. The effects of weak output growth in 1979 and 1980, and rising unemployment in the latter year may partly explain the increase in the share of GNP attributable to transfer payments—with the remainder being due to developments in social policies. The cause of the increased share of GNP taken by public goods and services is indicated by the fact that, while its share of GNP in nominal terms increased by 3.7 per cent between 1978 and 1980, the increase, in constant price terms, was a mere 0.2 per cent. One can conclude that Government current expen-

¹¹NESR Report No 21, *Report on Public Expenditure*, (July 1976).

diture on goods and services is increasing, due primarily, to the rise in the price of such goods and services, relative to the prices of other goods—a price rise due in part at least to relative wage movements between the public and private sectors.¹²

1.25 The numbers employed in public sector service activities have increased significantly in recent years, with an annual growth rate of 3.6 per cent per annum between January 1977 and January 1980. (Table 16) These increases have, however, occurred in a period of rapid service sector expansion, with the result that the share of public sector service employment in total service employment increased only slightly over this three year period, from 42.3 per cent in 1977 to 42.8 per cent in 1980. Preliminary figures for January 1981 indicate that public sector service employment grew by some 3 per cent during 1980, while private sector service sector employment remained unchanged.

1.26 Exchequer pay costs increased by 25.1 per cent in 1979, and by a further 34.6 per cent in 1980. (Table 17) As a consequence of these increases, public service remuneration as a share of National Income increased from 16.7 per cent in 1978 to 21.9 per cent in 1980, while average real remuneration of employee paid by the Exchequer increased by approximately 19 per cent over the two years.¹³ Such remuneration data must be interpreted with caution, as they are distorted by the impact of back-dated pay increases on the pay bill in any individual year. Furthermore, the remuneration bill includes overtime earnings, which may vary significantly from year-to-year, thereby affecting the year-on-year increases. Finally, calculations based on average remuneration per employee may hide the different experiences of differing groups of income-earners in the public service. For example, over half the increase in real remuneration per employee in the Exchequer pay bill in 1980 was attributable to increased remuneration of employees of the Health Boards and the voluntary hospitals.¹⁴ While accepting these qualifications, the 19 per cent increase in real remuneration per employee is in contrast to the 3.25 per cent increase in the volume of GNP over the same period. Real income increases of this magnitude are

¹²The divergence may also be attributed to the effect of measured productivity growth in private sector activities; however this factor is likely to be of very limited significance in a period as short as two years.

¹³National Income equals Net National Product at factor cost. Sources: *Economic Review and Outlook (ERO)* Summer 1980 and The Economic and Social Research Institute, *Quarterly Economic Commentary (QEC)*, April 1981. An alternative estimate provided by the Department of Finance suggests that the increase in real pay costs was of the order of 17 per cent over these two years.

¹⁴Department of Finance. The health employees pay increase included significant back-dated pay awards in respect of 1979.

largely a consequence of special pay awards in certain public service activities, which accounted for £260 million during the two years 1979 and 1980—10 per cent of total public service remuneration for the two years.¹⁵ The burden of such special pay awards on the Exchequer is substantial, with pay expenditure in excess of the pre-budget estimate in 1980 being equivalent to 5.8 per cent of total tax receipts and 15 per cent of income tax revenues.

1.27 The special pay increases of recent years were, in part, a response to previously slow growth in public service remuneration per employee, which actually declined in real terms between 1975 and 1977. Some insight into relative movements in different income groups over time can be obtained by examining the period 1975-80 as a whole. (Table 18) In addition to the qualifications mentioned in 1.26, two further important qualifications with regard to public service pay figures must be mentioned. First, the different experiences of different income-earners within public sector activities means that public service pay growth is highly sensitive to the exact definition of the public service used. While Exchequer pay costs per employee increased in real terms by 26.4 per cent during 1975-80, an alternative definition of the public service, including local authority employees but excluding Post Office employees and certain other categories of Exchequer-financed employment, showed a real increase of only 13.2 per cent over the same period.¹⁶ Over this 5-year period, the volume of GNP increased by 17.25 per cent while GNP per worker increased by 7.75 per cent. Second, given the differences in skill levels between employees in the transportable goods industries and many employees in the public service, disparities in income growth revealed in Table 18 may be a consequence of shifts in the distribution of income between differing skill levels rather than any public/private sector shift. Furthermore, given that salaries of many public service employment categories are linked to private sector activities in the commerce, insurance and finance sectors, which are primarily sheltered sector activities, disparities in income growth may be attributable to differing income movements in the exposed and sheltered sectors rather than any shift between the public and private sectors. In consequence of these qualifications, comparison of public service incomes with incomes in corresponding private sector activities would not be possible without a detailed study of individual occupations.

¹⁵ Minister for Finance, Budget 1981.

¹⁶ As an indication of the importance of one or two income groups in affecting the aggregate public service remuneration data, it is noteworthy that, in the absence of any real remuneration increase in the health sector between 1979 and 1980, the aggregate public services real earnings increase between 1975 and 1980 would have been 18.9 per cent, instead of the 26.4 per cent mentioned above.

1.28 Despite an increase of 6.0 percentage points in Government current expenditure as a share of GNP between 1978 and 1980 (Table 15), total tax revenue as a share of GNP increased by only 4.1 percentage points with the residual increase financed chiefly by increased borrowing. Taxes on income and wealth increased as a share of total tax revenue, and accounted for 3.3 percentage points of the increase in tax revenues relative to GNP. (Table 19)

1.29 The failure of tax increases to match the increase in Government current expenditure resulted in an increasing current budget deficit. The current budget deficit increased from 3.8 per cent of GNP in 1977 to 7.3 per cent in 1979, although it fell slightly to 6.6 per cent in 1980. (Table 20) The scale of budget deficits and the expansion of Government capital expenditure have resulted in substantial increases in the borrowing requirement of the Exchequer, which has increased, relative to GNP, each year since 1977. The Exchequer borrowing requirement in 1980 amounted to £1,217 million, 14.6 per cent of GNP, compared with 14.0 per cent of GNP in 1979, and 13.0 per cent in 1978. (Table 25) The more broadly defined public sector borrowing requirement, which comprises the borrowing of the Exchequer, State-sponsored bodies and local authorities, has also increased relative to GNP in each of the last three years, and amounted to 18.9 per cent of GNP in 1980.

1.30 The increased magnitude of the Exchequer borrowing requirement has resulted in an increased reliance on foreign borrowing to supplement the supply of savings available domestically. Foreign borrowing by the Exchequer amounted to 6.4 per cent of GNP in 1979 and 7.0 per cent of GNP in 1980 (Table 20), while foreign borrowing as a share of total Exchequer borrowing increased from 35 per cent in 1978 to 48 per cent in 1980. (Table 21)

1.31 The foreign indebtedness of the State has been notably increased by the scale of foreign borrowing, with outstanding Government foreign debt increasing rapidly in recent years. (Table 22) The external debt of the State-sponsored bodies more than doubled between 1978 and 1980, while the official external reserves increased by less than 10 per cent. As a consequence, the ratio of official external debt to external reserves increased from 1.11 in 1978 to 2.25 in 1980.¹⁷ While the interest rate structures of official debt and external reserves are substantially different,

¹⁷ The external debt data of the State-sponsored bodies excludes foreign currency-denominated borrowing from Irish resident banks. If such borrowing were included the corresponding debt-reserves ratios would be 1.23 in 1978 and 2.41 in 1980.

an increase in this ratio of such a magnitude is indicative of dramatically increased net State indebtedness.

Fiscal Policy

1.32 The usefulness of fiscal and monetary policies as demand management tools in a small open economy such as Ireland is severely constrained by the sensitivity of imports to movements in final demand, and the sensitivity of domestic interest rates to external interest rate movements. The scope for encouraging output and employment growth through fiscal policies is limited by leakage of increasing demand into imports of goods and services and the consequent deterioration in the balance of payments position. Domestic monetary policies can have little effect on interest rates given that Irish interest rates still must remain broadly in line with interest rates abroad.

1.33 Increases in Government expenditure on domestically produced goods and services or transfer payments provide a stimulus to output and employment. Increased taxes which reduce disposable incomes and consumption have a contractionary effect on output and employment. The stance of fiscal policy can be broadly summarised by the change in the borrowing level of the Government relative to GNP. Since 1977, the Exchequer borrowing requirement as a share of GNP has increased each year, indicating that fiscal policy has provided a strong expansionary stimulus in recent years.

1.34 One regrettable aspect of fiscal policies in 1979/80 is the increasing scale of error in budgetary forecasts. Estimates in the budget statements of 1979 and 1980 suggested that the Exchequer borrowing requirement would amount to 10.5 per cent in both years, while the actual out-turns were 14.0 and 14.6 per cent of GNP, respectively. The actual current budget deficit in 1979 was 80 per cent greater than forecast in the 1979 Budget, while the 1980 out-turn was 50 per cent greater than the forecast in the 1980 Budget. While the effect of the 1979 postal strike affected the revenue estimates in 1979, it is noteworthy that over half the forecast error for the current budget deficit in that year was attributable to the overshooting of the current expenditure target. In 1980 almost all the forecast error was due to expenditure, both capital and current, being substantially greater than expected.

Monetary Policy

1.35 The primary goal of monetary policy in recent years has been the maintenance of an adequate level of official reserves, without severely affecting the domestic supply of funds for investment. Restrictions on the expansion of domestic credit to the private sector have been used to

protect the level of reserves, by inducing private capital inflows to satisfy domestic demands. The role of external borrowing by the commercial banks in meeting private sector credit demand was particularly marked in 1980, when the net external liabilities of the commercial banks increased by £312 million in comparison with a £17 million increase in 1979.¹⁸

1.36 Monetary developments in 1979 and 1980 have been heavily influenced by the increased scale of the Exchequer borrowing requirement and the manner in which it has been financed. Government borrowing by monetary means—i.e. through foreign borrowing or borrowing from the domestic banking system—increased by 40 per cent in 1979 and by 16.5 per cent in 1980. The contribution of the Government to the expansion of domestic credit has increased from 38 per cent of domestic credit expansion (DCE) in 1978 to 55 per cent in 1980. (Table 23) In the non-Government sector, which includes the State-sponsored bodies, there was a marked slowdown in the rate of increase of bank credit in 1980, due partly to declining private sector demand and partly to the increased scale of direct foreign borrowing by domestic companies and residents.

¹⁸Part of the data underlying these figures is based on location of bank branch rather than residency of customer. Bank inflows based on residency of customer amounted to £400 million in 1980.

have reached 7.5 per cent by the end of 1981, compared with 5.6 per cent in 1979.⁵

2.3 Despite the strong upward pressure on prices resulting from the oil price increases, inflation in the OECD has peaked, at an estimated 12.9 per cent in 1980 with the increase in consumer prices expected to decline to 10.4 per cent in 1981, and to less than 9 per cent in 1982.⁶ The easing in inflation since mid-1980 suggests a relatively smooth adaptation to the effects of the oil price rises. Among the factors contributing to the relative ease of adjustment to the oil price shock in the industrialised countries have been maintenance of tight demand management policies, the slower than expected wage growth and the weakness of non-oil primary commodity prices.

World Trade

2.4 The expansion of international trade has been strongly affected by oil price increases and other contractionary pressures in the industrialised countries, with the volume of world trade growing by 1 per cent in 1980, compared with 6 per cent in 1979.⁷ The outlook for 1981 suggests limited growth of the order of 1 per cent with a resumption of faster growth during 1982. The exports of the OECD countries, having fallen in the second half of 1980, are expected to increase by 1.75 per cent in 1981, compared with 4.25 per cent for 1980 as a whole.⁸ Of greater importance for Ireland (which sent 87 per cent of its exports to the OECD countries in 1980)⁹ is the fact that the volume of intra-OECD trade is likely to show a slight decline this year, in comparison with 2 per cent to 3 per cent growth in 1980, and the 8 per cent to 9 per cent increase recorded in 1979.¹⁰ Within the European Community, intra-EEC trade is expected to decline by 1 per cent in 1981, compared with an annual average increase of over 8 per cent in the years 1977-79.¹¹

United Kingdom

2.5 The immediate outlook for the UK economy is one of continued output decline, accompanied by declining inflation. Gross Domestic Product, having declined by about 1.75 per cent in 1980, is forecast to decline by a further 1.5 per cent in 1981, with little, if any, change

⁵EEC Commission, *European Economy*, March (1981).

⁶NIESR *op. cit.*

⁷NIESR *op. cit.*

⁸OECD *op. cit.*

⁹OECD, *Statistics of Foreign Trade*, March (1981).

¹⁰OECD *op. cit.*

¹¹*European Economy*, November 1980; March (1981).

CHAPTER 2

ECONOMIC OUTLOOK: 1981 AND 1982

International Economic Trends

2.1 The prospects for Irish economic growth must be viewed against the international background of slow growth and rising unemployment. The sharp increases in oil prices in 1979 and 1980 provided a strong contractionary shock to the major industrialised countries. Demand management policies in these countries have augmented this deflationary impact, reflecting policy-makers' concern with the increase in the rate of inflation. GDP growth in the OECD as a whole slowed down from mid-1979 onwards, with output actually declining in the second half of 1980. The immediate outlook is one of slow recovery from the trough of the recession, although the rate of growth of output is unlikely to reach its 1979 level before late 1982, at the earliest. The GDP of the OECD countries is forecast to increase by 1-1.5 per cent in 1981; a similar growth rate to that recorded in 1980.¹ The recovery in the economies of the European Community is likely to be slower than for the OECD as a whole, with recent forecasts indicating that GDP in 1981 will be about 1 per cent lower than in 1980.²

2.2 The effects of the slowdown in economic activity on labour demand have resulted in declining employment in the OECD countries. Total employment in the seven major industrialised economies declined during the second half of 1980 and little increase is expected before 1982.³ Unemployment in the OECD increased from 5.3 per cent of the labour force in the first quarter of 1980 to 6.4 per cent a year later, with further increases expected during 1981.⁴ Employment in the European Community is expected to decline by close to 1 per cent in 1981, reflecting the relatively poor output performance of the Community economies, while the unemployment rate is expected to

¹OECD, *Economic Outlook*, July 1981; *National Institute Economic and Social Review* (NIESR) May (1981).

²OECD *op. cit.*

³OECD *op. cit.*

⁴NIESR *op. cit.*

in 1982.¹² Declining demand in the UK, and an associated destocking by UK producers, has resulted in a declining volume of merchandise imports, which fell by 5 per cent in 1980, and are expected to show a further decline of 5 per cent to 6 per cent in 1981.¹³ The use of quarterly data, however, indicates that the bulk of the import decline occurred in the second half of 1980, with imports falling 11 per cent between the second and fourth quarter of that year.¹⁴ Import demand continued to decline during the first quarter of 1981, with recovery beginning in the second quarter. Such has been the scale of decline in import demand, however, that the volume of merchandise trade is not likely to reach its second quarter 1980 peak before early 1983.¹⁵

Price inflation has continued to ease in the UK, aided by the anti-inflationary stance of demand management policies and the appreciation of the exchange rate, and is expected to decline further in 1981 and 1982 although such forecasts are sensitive to exchange rate movements. Between the fourth quarter of 1980 and 1981, consumer prices are expected to increase by about 10.5 per cent compared with 13 per cent in the preceding year, while inflation should fall further in 1982.

2.6 In conclusion, two major features of the prospective external environment for the Irish economy in 1981 and 1982 are of particular importance:

- (i) the limited expansion in import demand in Ireland's major export markets
- (ii) the general easing of inflationary pressures in Ireland's main trading partners, most notably the United Kingdom.

A third feature of importance is the increasing variability of international exchange rates which may affect the competitiveness of Irish exports, and the costs of Ireland's imports.

Comparison of the two "oil-related" Recessions

2.7 Given the significant causal role played by real oil prices in the present downturn in economic activity, some insight into future economic prospects can be obtained from a comparison of the present experience with economic events in 1973-76.

¹² 13NIESR; OECD

¹⁴ NIESR

¹⁵ NIESR, seasonally adjusted data.

2.8 The scale of the oil price shocks in 1979-80 and their direct effects on the economies of the European Community are of a similar order of magnitude to the experience of 1973-74. While the percentage increase in oil prices was substantially greater in the earlier period, due to the low initial base, the absolute increase (in constant 1973 prices) is estimated to have been \$8.7 per barrel in 1979-80 compared with \$7.3 in 1973-74.¹⁶ The direct increase in the oil bill of the European Community amounted to an estimated 3.1 per cent of GNP in 1979-80, in comparison with 3.0 per cent in 1973-74.¹⁷

2.9 Both internal and external developments in 1979-80 suggest, however, that the adjustment of the European economies is likely to be relatively smoother in the present recession. Among the main factors facilitating such adjustment at present are:

- (i) the decline in real income due to the deterioration in the terms of trade is less than half the reduction that occurred in 1973-74, due chiefly to the comparatively slow growth in non-oil primary commodity prices in 1979-80
- (ii) the slower-than expected growth in unit wage costs,¹⁸ and the absence of a marked "psychological" effect on business expectations, both of which have assisted in preventing a marked decline in investment.

As a consequence of these developments, among others, the present recession is likely to be less marked in its effects on output and investment than was the case in 1974/75. (Table 25) Inflation is likely to fall somewhat more rapidly than in the previous recession, when inflation remained above 12 per cent in both 1974 and 1975. Fixed investment in 1981 is expected to be slightly higher than the volume achieved in 1979, in contrast with an 8 per cent decline between 1973 and 1975. While most recent forecasts suggest that output is likely to decline in the Community in 1981, the decline is expected to be less marked than the 1.4 per cent decline in GDP recorded in 1975. The present recovery is, however, likely to be slower than in 1976, reflecting policy-makers' continued concern with inflation.

2.10 While prospects for the European Community as a whole indicate that the present recession is likely to be less severe than the previous recession, there are a number of factors which suggest that the outlook for the Irish economy is more unfavourable than in 1973-75.

¹⁶, ¹⁷ *European Economy*, November (1980).

¹⁸ EEC real unit labour costs are expected to increase at an annual average rate of 0.2 per cent between 1979 and 1981, compared with 2.7 per cent in 1974-75.

First, the immediate outlook for Irish agriculture is relatively poor, in marked contrast with the experience of 1973-75, when the net output of Irish agriculture increased by 19.1 per cent in volume terms. The importance of agriculture as a contra-cyclical factor was particularly marked in 1975, when agricultural output increased by 10.7 per cent, and the output of all other private sector activities declined. Given that net agricultural output is forecast to decline in 1981, it is clear that the performance of agriculture in the present recession is tending to worsen the impact of the recession on Irish incomes and output. Furthermore, recent trends in agricultural prices have augmented the deterioration in the terms of trade.

Second, the financial position of the State at the outset of the present recession was markedly inferior to the corresponding situation in 1973-74. (Table 26) The current budget deficit as a share of GNP amounted to 5.8 per cent on average, in the three years 1977-79, in contrast with 0.23 per cent for the years 1971-73, while the Exchequer borrowing requirement averaged 12.4 per cent in the later period, compared with 7.3 per cent in 1971-73. The initially serious budgetary position and associated borrowing level has imposed a major constraint on the scope for effective contra-cyclical budgetary policies, such as occurred in 1974-75, when the Exchequer Borrowing Requirement, relative to GNP, increased by 8.2 per cent over two years.

Third, the foreign payments position of the economy at the beginning of the present recession was substantially worse than the corresponding position in 1973, indicating that the underlying balance of payments position provides a more serious constraint on domestic policies than was previously the case. The current account deficit amounted to 10.1 per cent in 1979, compared with 3.1 per cent in 1973. (Table 26) Even allowing for the effects of a poor agricultural export performance in 1979, the average external current account deficit for 1977-79 was 5.1 per cent of GNP, as against 3.0 per cent in 1971-73. The increased level of official foreign indebtedness—208 per cent of official reserves, and 28 per cent of GNP in December 1979, as against 76 per cent and 12 per cent respectively, in March 1974—has resulted in an increasing amount of foreign exchange being required to finance the foreign debt, which places increasing pressure on the balance of payments position, thereby further constraining domestic policies.

2.11 In conclusion, while the evidence suggests that the European Community is likely to suffer less output decline and inflation in the present recession, as compared with 1973-75, the outlook for agricultural output and the constraints on domestic policies imposed by

the budgetary position and the balance of payments suggest that Ireland will fare less well *vis-a-vis* the Community than was the case in 1973-75, when Irish GDP increased by 5.9 per cent in volume, compared with an increase of 0.3 per cent in Community GDP.¹⁹

Agricultural Outlook

2.12 The progress of the agricultural economy in 1981 is being significantly affected by producers' decisions in previous years and by price/cost relationships in the current year. For some commodities such as cattle, sheep and pigs, the volume of output in a particular year is primarily determined by the level of the breeding herd in that year, but for such sectors as milk and tillage the interaction of current output and input prices may have a significant influence on output and margins. Furthermore, market balances and processing cost levels may exert a strong impact on agricultural prices, although the outcome of the annual EEC price review usually attracts much more attention in this context.

2.13 The output of cattle including inventory change in 1980 was about 1.64 million, while output for 1981 is expected to be of the order of 1.6 million. The components of output for certain years are shown in Table 27. Of particular interest is the greatly reduced level of disposals (i.e. exports plus domestic consumption) in 1981 relative to 1980. Output excluding inventory is expected to fall from 2.06 million to 1.55 million but stocks are expected to increase slightly. Furthermore, the pattern of marketing to-date suggests that about two-thirds of total disposals will arise in the second half of the year. Prices have been about 20 per cent above the corresponding level in 1980, but the differential is likely to narrow as the year progresses.

2.14 Despite reduced cow numbers, milk production was higher in the first four months of 1981. However, weather conditions deteriorated sharply in May and it is now anticipated that annual supplies will be little different from the depressed levels of 1980, with milk prices expected to be about 14 per cent higher than in 1980. Little change is expected in the output of sheep and lambs although prices are significantly higher, but pig production will probably decline by 6 to 7 per cent. Pig prices however might be about 15 per cent higher than in 1980 and numbers will probably stabilise at a slightly lower level than in 1980.

2.15 As regards tillage crops, the most recent indications point to

¹⁹ *European Economy*, November (1980), Annex: Table 7.

a further slight increase in the area under cereals comprised of a decline in wheat, especially spring wheat and an increase of perhaps 6 per cent in feed barley. Favourable planting conditions in the spring of 1981 have been more than negated by adverse climatic conditions in May and June and the cereals sector output is unlikely to increase above last year's level. Little change is expected in the potato acreage but the response to the campaign for increased acreage of sugar beet from the Irish Sugar Company seems to be very positive. The area devoted to the crop will probably expand by about 9 per cent and with the yields and quality achieved in 1980 the average price per tonne of sugar beet should be approximately 15 per cent higher.

2.16 It is generally anticipated that the output price index will increase by about 14 per cent in the current year, largely originating in the livestock and livestock product sectors. Input costs will probably increase at a slightly slower pace varying from about 9 per cent for feedingsuffs to 30 per cent for farm fuels. However, some reduction is expected in the consumption of fertiliser in line with the decline in cattle numbers, but little change will arise in the volume of other inputs. Indications to date suggest depressed activity in investment both in farm buildings and machinery, but depreciation charges will continue to increase somewhat. The rates bill on agricultural land is expected to be £19.6 million lower than it would otherwise be owing to the concession granted in the Budget.²⁰

2.17 Having regard to the expected movements outlined in the price and volume components of output, farm materials and expenses, it is estimated that the value of gross agricultural output will increase by about 9 per cent this year, but volume could be down by about 4 per cent. (Table 28) The value of net output should increase by approximately 9 per cent, but volume would be expected to fall by 5 to 6 per cent.

2.18 When other items of expenditure including rates, depreciation, fuel and wages are deducted from net output, income from self-employment is projected to increase about 14 per cent in nominal terms.²¹ While the increase realised in the annual EEC price review and through devaluation of the reference rate for the Irish Green Pound was slightly more than sufficient to compensate for the rise in farm input costs in 1981, the rise in farm incomes can also be attributed to rates relief, increases in headage payments and the temporary

²⁰Budget 1981, p. 24.

²¹Should cattle prices be maintained through the autumn despite increased marketings, the increase in incomes could be of the order of 16 to 17 per cent.

suspension of the disease eradication levies, while the measures agreed in Brussels in April include incentives to increase lime consumption and silage production, to aid livestock performance and progeny testing programmes and to subsidise the use of A.I. for beef production. The total cost of the measures agreed in Brussels will be £51 million over two years, of which the EEC will contribute £31 million.

Manufacturing Industry

2.19 The expansion of manufacturing output and employment in Ireland can arise from three distinct sources:

- (i) the expansion of established firms, both native and foreign owned
- (ii) the inflow of new industrial projects from abroad and
- (iii) the setting-up of new domestic firms.

2.20 The prospects for output and employment in established industry will be largely determined by the speed of recovery from the present recession. The movement in manufacturing output and employment in the 1974-75 period provides a useful illustration of the pattern of fluctuations in manufacturing industry during a recession. International experience suggests that in the initial stages of a downturn in economic activity, output declines significantly, while employment is only slightly affected, as firms retain their labour force in the short-run. As the recession deepens, employment losses begin to follow the decline in output, as firms adapt their labour force to suit the lower output requirements. This pattern of downward adjustment in the labour force continues even as the output decline "bottoms out". During the initial stages of recovery, output growth is accompanied by improved productivity, reduction in short-term working and increased overtime, rather than employment growth.

These relationships are highlighted in the Irish experience of 1974-75. (Chart 1) Between the first and third quarter of 1974, output in manufacturing industry fell by 3.8 per cent, while employment fell by 0.9 per cent. In the succeeding six months, both output and employment fell substantially, by 5.8 per cent and 4.2 per cent respectively. Between the first and third quarter of 1975, output decline was less marked, at 1.5 per cent, while employment continued to decline by over 4 per cent. Finally, the period between the third quarter of 1975 and the first quarter of 1976 saw the initial recovery, with output increasing by 10.1 per cent, but employment still showing a very small decline of 0.3 per cent. In the present recession, output decline commenced from the first quarter of 1980, with manufacturing output de-

clining by 3.5 per cent over the next two quarters, and a further 3 per cent in the fourth quarter of 1980.²² Employment in manufacturing has been in decline since December 1979, and had fallen by 3.1 per cent by September 1980²³ suggesting that firms are adjusting their demand for labour to the level of output at a faster pace than occurred in 1974. Were the 1974-75 cycle to be repeated in the present situation, one would expect output recovery to occur in the second half of 1981, with employment beginning to recover in early 1982. In fact, the recovery in output may occur sooner, given that manufacturing output increased by 7 per cent between the fourth quarter of 1980 and the first quarter of 1981.²⁴

2.21 Given that new industrial projects require a number of years in operation to approach their output and job approvals targets, the chief impact of new industrial overseas projects in 1981 and 1982 will arise from projects set up in 1978-80. As job approvals from new overseas projects recorded in these years were high by previous experience, this should provide a relatively favourable stimulus to output and employment growth in 1981-82. Although projects attracted to Ireland in 1981 and 1982 will have limited immediate effects on manufacturing industry, the scale of the inflow of projects is likely to be of key importance in assisting the expansion of the Irish industrial sector over the medium-term. The slow recovery of manufacturing employment over from the previous recession²⁵ was at least partly attributable to the slump in the number of job approvals from new overseas firms in 1975 and 1976, when job approvals recorded in both years were less than 60 per cent of the 12,700 attained in 1973.²⁶ While it is unlikely that a slump of such magnitude will occur in 1981-82, the effects of high job approvals on industrial output and employment will depend on the conversion rate of job approvals into actual employment, which may decline significantly given weak demand conditions.

Fiscal Policy

2.22 Prior to examining the likely trends in the individual components of GNP in 1981, it is necessary to consider the likely impact of fiscal and monetary policies on these components. The chief features of fiscal policy in 1981, as indicated in *Budget 1981*, were to be a small nominal decrease in the current budget deficit, a marked increase in the scale of

²²Monthly Industrial Enquiry, December (1980).

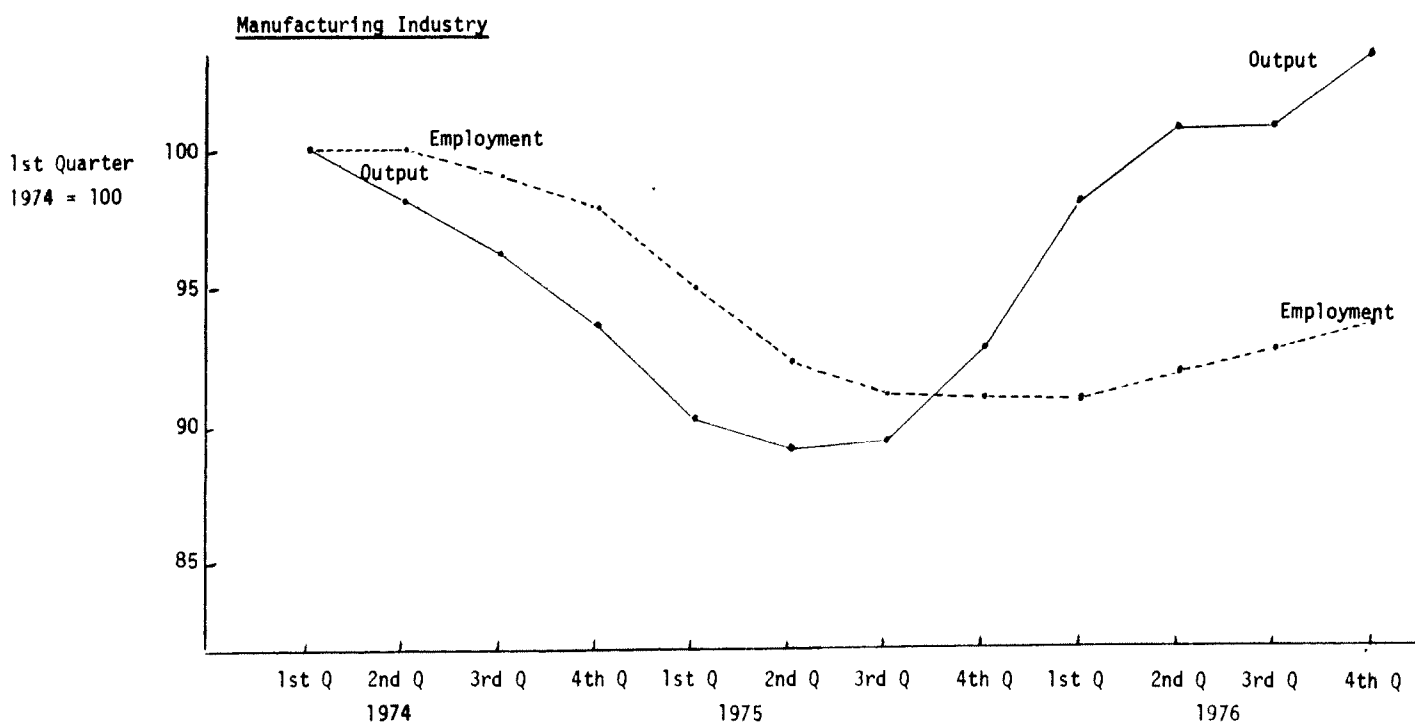
²³Employment, Earnings, Hours worked, September (1981).

²⁴Monthly Industrial Enquiry, March (1981), seasonally adjusted figures.

²⁵Manufacturing employment did not recover to its March level until March (1979).

²⁶IDA *Annual Reports*, (1978), (1979).

CHART 1
OUTPUT AND EMPLOYMENT; 1974-76



Source:- ISB July 1977

Note:- Employment Data is March, June, September, December, not quarterly

public capital expenditure and a decrease in the Exchequer borrowing requirement relative to GNP.

With regard to the current budget deficit, actual developments in the first six months of 1981 have suggested that the scale of the increase in Government current expenditure, in particular, was incompatible with the target set in *Budget 1981*.²⁷ *The Financial Statement of the Minister for Finance*, 21 July 1981, indicates that the current budget deficit for 1981, allowing for the measures announced in the statement, is now expected to be £787 million, some 7.9 per cent of GNP, in comparison with the £547 million deficit recorded in 1980, an estimated 6.6 per cent of GNP.

2.23 The capital budget for 1981 provided for a substantial expansion of investment expenditure by the State, both on building and construction activities (33%), and on machinery and equipment expenditure by State agencies and capital grants to the private sector (58%).

Revised estimates presented in the *Financial Statement* of July 1981 suggest that expenditure on the Public Capital Programme during the current year will be 3 per cent greater than estimated in *Budget 1981*, with total capital expenditure likely to be £1,884 million, a 43.9 per cent nominal increase on 1980 expenditures. One innovative feature of the present public capital programme is the allowance made for private sector participation in the financing of public investment, expected to amount to £200 million in 1981.²⁸ One effect of such private participation in the public capital programme is to reduce the capital borrowing requirement of the Exchequer relative to what it would otherwise have been. Consequently, the capital borrowing requirement of the Exchequer in 1981 is expected to be £850 million, or 8.6 per cent of GNP, while capital borrowing including private sector participation should be £1,050 million—10.6 per cent of GNP.

2.24 Given the likely scale of the current budget deficit and the level of capital borrowing, the conventionally defined Exchequer borrowing requirement in 1981 could amount to £1,637 million, an estimated 16.5 per cent of GNP. The more broadly defined public sector borrowing requirement, which includes the borrowing of the State-sponsored bodies and local authorities, is likely to be about £2,100 million, or 21.1 per cent of GNP.

²⁷ERO, Summer (1981).

²⁸Up to £100 million is expected to be made available by the commercial banking system to finance the development of the telecommunications system. Details concerning the remaining £100 million have yet to be announced.

2.25 Movements in the scale of the State borrowing requirement provide a broad indication as to the impact of fiscal policy on output. However, the sensitivity of the borrowing requirement to the level of economic activity itself makes comparison of the fiscal impact of borrowing levels at different stages in the business cycle less straightforward than simple year-to-year comparison. Furthermore, for a given borrowing requirement, the method by which it is financed will significantly affect the magnitude of the stimulus to output, with financing by monetary means (i.e. borrowing from abroad, or from the banking system) being more expansionary and inflationary than borrowing from domestic residents. The forecast Exchequer borrowing requirement of 16.5 per cent of GNP in 1981, and a corresponding public sector borrowing requirement of 21.1 per cent, can be compared with corresponding figures for 1980 of 14.6 per cent and 18.9 per cent, respectively, suggesting that budgetary policies will provide a significant expansionary impetus to the economy in 1981.

In the absence of private sector participation in the public capital programme, the Exchequer borrowing requirement in 1981 would amount to 18.5 per cent of GNP, with a public sector borrowing requirement in excess of 23 per cent of GNP.²⁹

2.26 The Central Bank, in its *Statement on Monetary Policy* has announced quantitative credit guidelines which permit a 15 per cent increase in the amount of non-Government credit extended by the commercial banks in the year from mid-February 1981. As the new credit guidelines include the onlending of capital inflows from abroad, in contrast with their exclusion for the greater part of the last credit year, the present credit expansion target of 15 per cent is not directly comparable with the 13 per cent expansion permitted in the twelve months from February 1980. However, on the assumption that up to £200 million of non-Government lending will be required to finance private sector participation in the public capital programme, the expansion of bank credit to other private sector activities and State-sponsored bodies would be about 11 per cent during the present credit year, suggesting a somewhat tighter monetary stance than that taken during the 1980 credit year.

²⁹If participation in the PCP by the commercial banking system were to be exempted from the credit guidelines on non-Government lending of the banking system, the expansionary effects of present fiscal policy would be equivalent to a situation where the Exchequer borrowing requirement amounted to 18.5 per cent of GNP, with a corresponding public sector borrowing requirement of 23 per cent of GNP. See ESRI, *Quarterly Economic Commentary*, July (1981), Appendix.

Output and its components 1981

2.27 The primary factors influencing GNP in 1981 are the weak external environment facing Irish exports, the marked expansion, both in real and nominal terms, of public investment expenditure, and the effects of the agricultural price package, input cost increases, and the destocking of 1980 on agricultural output and incomes.

2.28 The main influences on private consumption expenditure in 1981 are the growth of agricultural incomes from the low level of 1980, and the limited scope for any further decline in the savings ratio of 19 per cent recorded in 1980.³⁰ This savings ratio is the lowest recorded since 1974, and represents a significant decline from the annual average of 23 per cent during the period 1977-79. Agricultural incomes are expected to increase by about 15 per cent while non-agricultural incomes should increase by close to 18 per cent, although there should be divergent movements in earnings within the non-agricultural sector, with earnings in public sector services and building and construction increasing relative to other sub-sectors. Personal incomes as a whole should increase by close to 18 per cent, with personal disposable incomes increasing somewhat more than this, aided by the 2 per cent increase in disposable incomes attributable to income tax and social welfare changes in the budget.³¹ Assuming an unchanged savings ratio and an increase in the private consumption deflator of 20 per cent (discussed below), the volume of private consumption expenditure is likely to show a slight decrease on the 1980 level, with a value increase of about 19 per cent (Table 29).³²

2.29 In the 1981 Budget statement, central Government expenditure on goods and services was expected to increase by 16.5 per cent, with non-capital supply services excluding expenditure by the Department of Social Welfare expected to increase by 13.2 per cent. Revised estimates in the *Financial Statement* of 21 July 1981, indicate that expenditures on the latter are now expected to increase by 24.5 per cent.³³ While transfer payments other than social welfare expenditure may have increased relative to expenditures on goods and services, public expenditure on goods and services should increase in nominal terms by at least 20 per cent. The likely increase in the price index for such goods

³⁰ QEC April (1981).

³¹ Derived from *Budget 1981*, page 40.

³² While retail sales volume in the first quarter of 1981 are 1.8 per cent down on the corresponding period in 1980, new car sales in first five months are up by 9.3 per cent, suggesting that some consumption items are experiencing substantial growth.

³³ Estimated from *Budget 1981*, ERO Summer (1981), *Financial Statement of the Minister for Finance*, 21 July 1981.

and services will depend primarily on the scale on nominal earnings levels in public service activities, given that, in 1980, some 63 per cent of current budget expenditure, excluding transfer payments, was accounted for by pay expenditure. Between 1978 and 1980 the price index for public expenditure on goods and services increased by 15 per cent relative to the private consumption expenditure deflator. While average incomes in public service activities may increase relative to other incomes, the expected decline in the real value of personal incomes suggest that a relative price effect of this magnitude is unlikely in 1981. Assuming an increase in the price index for public goods and services of 21 per cent, the volume of public expenditure on goods and services is unlikely to show any significant change in the current year.

2.30 The primary influence on gross domestic fixed capital formation in 1981 is the planned expansion of the public capital programme. Private sector investment expenditure, after a marked decline in 1980,³⁴ is unlikely to show any significant increase in 1981 given the unfavourable demand situation, rising interest rates and the weak agricultural situation. Assuming a small decline in non-public capital expenditures, the volume of investment expenditure should increase by about 8 per cent with an average price increase of about 18 per cent.³⁵ Expenditure on gross domestic fixed capital formation is likely to increase relative to GNP, with an investment ratio of about 32 per cent.

2.31 The demand situation facing Irish exporters is unfavourable, particularly in the United Kingdom, indicating that Irish export growth in 1981 is reliant upon the success in increasing market shares, rather than external growth in demand. Domestic supply factors are of importance with regard to agricultural export prospects, given the major destocking that occurred in 1980, and which provided a once-off expansion in exports in that year. Agricultural exports are consequently likely to fall in volume terms this year. Industrial export growth should continue to be aided by the coming "on stream" of new overseas industrial projects set up in recent years. Irish industrial exports should increase as a share of world manufactured exports, but this improving market share will be concentrated in a number of commodity classifications. The total value of exports is expected to increase by 16.5 per cent, composed of a price increase of 15 per cent and a volume increase of 1.25 per cent.

³⁴ Gross domestic fixed capital expenditure less public capital programme expenditure declined by 12.5 per cent in 1980, suggesting a volume decline of about 25 per cent.

³⁵ Cement sales in the first half of the year are up a mere 0.8 per cent on the corresponding period last year, suggesting limited increases in building and construction during the first half of the year.

2.32 After the substantial destocking which occurred in both agriculture and industry in 1980, the immediate outlook is for a slight recovery in physical stocks, although the magnitude is dependent upon the exact timing of the end of the destocking cycle. A change in physical stocks valued at about £20 million is assumed for 1981, compared with a decline of £145 million in 1980.

2.33 The expansion of investment on machinery and equipment, which is relatively import-intensive, should result in an expansion of imports of goods and services, although the importance of agricultural stock movements in the increase in final demand should partly offset the effect on the overall import propensity. Given an expected increase in the volume of final demand of 2.5 per cent in 1981, and assuming that the responsiveness of imports to increases in final demand is similar to the pattern of the 1970s, the volume of imports is expected to increase by 3.25 per cent. Despite the easing of international inflationary pressures import prices are expected to increase by about 18.5 per cent in 1981, due to unfavourable movements in Ireland's exchange rate.

2.34 Given the outlook for the individual components of aggregate demand, the value of GDP is expected to increase by close to 2 per cent in 1981, with an 18 per cent increase in the implicit price deflator for GDP. The growth in the volume of GNP is likely to be smaller, due to the increasing burden of interest payments on official debt which has resulted in a rapid growth in net factor payments abroad. While GNP in volume terms is likely to grow by almost 1 per cent, the further deterioration in Ireland's terms of trade will result in a decline of about 1 per cent in the volume of GNP adjusted for terms of trade movements.

2.35 The deterioration in Ireland's terms of trade and the faster volume growth of imports relative to exports will lead to a substantial deterioration in the current account deficit, which is forecast to be £1,375 million, about 13.8 per cent of GNP, compared with an estimated £700 million, 8.4 per cent of GNP in 1980.

Inflation

2.36 Inflationary pressures on internationally traded goods are expected to ease substantially in 1981, with foreign prices for most commodities increasing at substantially lower rates than in 1980. While traded goods prices in foreign currency terms are rising more slowly, the effect on the Irish inflation rate has been offset by the depreciation in the value of the Irish pound in terms of sterling and the US dollar. In the nine months, September 1980-June 1981, the value of the Irish pound has depreciated by 9.4 per cent in terms of sterling, and by 26.3 per cent in

dollar terms indicating substantial upward pressure on Irish currency prices of traded goods.³⁶ Movements in indirect taxes are also a source of price increases, with the £164 million revenue expected from new indirect taxes and increased Post Office charges in the 1981 Budget likely to add 3 per cent to the private consumption deflator in 1981. The tax and food subsidy measures announced in the *Financial Statement* of 21 July 1981 should add about 1 per cent to the year-on-year inflation rate for 1981, but should have an additional effect on the year-on-year inflation rate in 1982. As a consequence of these developments the year-on-year increases in the price index for Private Consumption Expenditure in 1981 is likely to be about 20 per cent compared with an 18.25 per cent increase in 1980.

Monetary Developments

2.37 Some tentative indications into the likely financing of the balance of payments deficit and its implications for the State's foreign indebtedness can be obtained from an analysis of the monetary implications of the Exchequer borrowing requirement and the Central Bank's credit guidelines.

2.38 The borrowing requirement of the Exchequer can be financed through non-monetary means, such as sales of securities to domestic non-bank residents, or an increase in savings with the Post Office Savings Bank or, alternatively, through monetary means, where the requisite funds are borrowed from the Central Bank, the commercial banking system, or abroad. The former involves a transfer of funds between sectors, whereas the latter entails an injection of funds into the economic system, and consequently has a more expansionary effect, with a correspondingly greater effect on the balance of payments position.

2.39 Non-monetary financing of the Exchequer borrowing requirement, at £345 million,³⁷ accounted for just over one-quarter of the total borrowing requirement of £1,217 million in 1980. Assuming a constant ratio of net sales of securities to non-bank domestic residents to personal disposable income, and allowing for a substantial increase in small savings, non-monetary financing could amount to £430 million in 1981, all other things being equal. Given an Exchequer Borrowing Requirement of £1,640 million in the current year, monetary financing

³⁶Central Bank, *Quarterly Bulletin*, Summer (1981).

³⁷In the present section, non-monetary financing is defined residually, as being equal to the Exchequer Borrowing Requirement less Net Foreign Borrowing by the State, less net Government borrowing from the banking system. See M. Kenneally, *Quarterly Economic Commentary*, September (1980).

of the borrowing requirement could amount to £1,210 million. Data from the first five months of 1981 show that net Government borrowing from the banking system had increased significantly compared with the corresponding period last year, suggesting that net borrowing from the banking system will be somewhat greater than in 1980, when it amounted to £299.4 million.³⁸ On the assumption that borrowing from the banking system could be as high as £350 million during the calendar year 1981, net foreign borrowing by the Exchequer should be of the order of £860 million, compared with £530 million in 1980. (Table 30)

2.40 On the basis of the output forecasts in 2.27 to 2.34 above, the balance of payments deficit on current account is expected to be £1,375 million in 1981. As in 1980, this deficit will be largely financed through official external borrowings both by the Exchequer and the State-sponsored bodies. Given that the level of external borrowings by the State-sponsored bodies is likely to be increased by the reduction in non-Public Capital Programme expenditures announced in the *Financial Statement* of 21 July 1981, external borrowings by these bodies could amount to £300 million in 1981, suggesting that the total net official external borrowings will be of the order of £1,160 million.³⁹ The remaining portion of the deficit will be largely financed through net external borrowings by the consolidated banking system, which can occur either through a flow decline in the official external reserves or through new external borrowing by the commercial banks.

2.41 Given the 15 per cent credit guideline of the Central Bank for the period February 1981/February 1982 and allowing for the rapid growth in credit during the last two months of the 1980 credit year, non-Government lending of the banking system could increase by about £850 million during the present calendar year.⁴⁰ Domestic Credit Expansion (DCE), which equals non-Government lending of the banking system plus the monetarily financed component of the Exchequer borrowing requirement, is expected to increase by approximately £2,050 million. Assuming an increase in the non-deposit liabilities of the banking system of the order of £250 million, net credit expansion

³⁸Central Bank, *Quarterly Bulletin*, Summer (1981). Borrowing from the banking system is defined to be the increment in Government lending of the consolidated banking system less the increment in Government deposits at the Central Bank.

³⁹The revised estimate for non-Public Capital Programme expenditure in the current year is £99 million, compared with an emerging position at end-June 1981 of £233 million.

⁴⁰Given that domestic non-Government credit, excluding private sector participation in the Public Capital Programme, is constrained by the credit guidelines to increase by approximately 11 per cent during the credit year, it is assumed that the demand for credit will grow in line with the credit guidelines.

—which is equal to the change in the money supply (M3) plus net external finance—is likely to be £1,800 million. (Table 30)⁴¹

2.42 Net external finance can arise from three sources:⁴²

- (i) net exchequer borrowing abroad
- (ii) net borrowings abroad by the consolidated banking system
- (iii) revaluation effects of exchange rate changes on the official external reserves and the net external liabilities of the banking system.

Assuming revaluation effects will reduce net external finance by £100 million below what it would otherwise be, and that net borrowings abroad by the banking system amount to £230 million, net external finance should be close to £1,000 million, indicating an expansion in the money supply of about £800 million during 1981.⁴³

2.43 The foreign indebtedness of the State has increased rapidly in recent years, from £1.4 billion at the end of 1978 to £3 billion in December 1980. Increasing indebtedness can arise from:

- (i) new borrowings abroad by the Exchequer and the State-sponsored bodies
- (ii) depreciation of the Irish pound relative to currencies in which Ireland's official external debt is denominated.

On the basis of the forecasts above, new official external borrowings will amount to about £1.15 billion in the current year. While somewhat over half the official external debt at end-year 1980 was denominated in EMS currencies, the deteriorating value of the Irish pound relative to the US dollar—which accounted for about one-fifth of the external debt at end-year 1980—should increase the value of outstanding debt during the current year. Given these developments, the end-year external debt is likely to be about £4.3 billion—a 40 per cent increase during the present calendar year. The increase in the net external liabilities of the public authorities—i.e. official indebtedness less official reserves—should

⁴¹A number of items in the consolidated balance sheet of the banking system are affected by revaluation effects arising from exchange rate changes. Non-deposit liabilities are affected by such changes, as are the official external reserves and the net external liabilities of the banking system.

⁴²Net external finance is defined to be net Government foreign borrowing plus the increase in the net external liabilities of the banking system less the increase in the official external reserves.

⁴³The seasonally adjusted money supply increased by £370.6 million during the first five months of 1981: Central Bank, *Quarterly Bulletin*, Summer (1981).

be of the order of £1.2 billion. Total net official external liabilities amounted to £1.7 billion in December 1980 in contrast to a mere £140 million in December 1978. (Table 22)

Employment and Unemployment

2.44 Employment in the twelve months from April 1981 to April 1982 is unlikely to show any increase at an aggregate level, although increases may occur in some sectors. Agricultural employment is expected to decline in line with its long-term trend, with the numbers employed declining by some 3,000/4,000. Employment in manufacturing industry, as discussed in 2.20 above, may decline somewhat over this period, with the magnitude of the decline depending upon the speed at which output growth recovers. Employment in building and construction should experience some growth, aided by the expansion of the public capital programme. For the industrial sector as a whole, employment is likely to be static, while the outlook for private consumption expenditure and public sector employment suggest little or no growth in service sector employment.

2.45 The rate of growth of the labour force has averaged 1.6 per cent per annum in the years 1975/1980, which if continued in 1981/82 would lead to an increase of 20,000 in the labour force in the twelve months from April 1981. Due to the effects of poor employment prospects on participation rates, the actual increase is likely to be less than this, although weak labour demand in other European economies suggests that the scale of induced emigration should be extremely small.

2.46 On the assumption that no employment growth takes place between April 1981 and April 1982, and that the labour force increases by close to 14,000, the unemployment rate in April 1982 is likely to be about 9.4 per cent, excluding school-leavers seeking their first job.⁴⁴ Including an estimated 15,000 such school-leavers in the labour force, the corresponding unemployment rate would be 10.5 per cent. This compares with an April 1981 unemployment rate, including school-leavers of 9.3 per cent.

Outlook for 1982

2.47 Given the uncertainty of the international environment, and its sensitivity to oil price movements and demand management policies in the large OECD countries, any forecasts of output and employment in

⁴⁴As noted above in footnote to 1.6 and 1.7, unemployment as used here refers to the unemployment definition used in Labour Force Surveys, and the recent Labour Force Statistics revision of the CSO.

the Irish economy in 1982 must be extremely tentative. The outlook hereunder assumes that there will be no alteration in the exchange rate value of the Irish pound relative to sterling, the US dollar, and the EMS currencies during 1982. It also makes a "neutral Budget" assumption in the following sense: no increase in the volume of Government current and capital expenditure on goods and services, and increases in line with the consumer price index of income tax allowances, specific taxes and social welfare payments in 1982.

2.48 At present, the external environment facing the Irish economy in 1982 appears likely to be characterised by a somewhat improved demand situation in export markets, and a relatively slow increase in traded goods prices. With constant exchange rates, prices of internationally traded goods in Ireland should increase much more slowly than in 1980-81, with a corresponding effect on increases in the Consumer Price Index (CPI). Given a forecast OECD year-on-year inflation rate of about 9 per cent, and allowing for some carry-over from 1981 exchange rate movements, export and import prices could increase by about 11 per cent, although there may be some movement in the terms of trade, probably adverse. The indirect tax increases announced in the *Financial Statement* of July 1981 will directly increase the year-on-year rate of inflation in consumer prices in 1982 by about 3 per cent. The CPI is likely to show an average year-on-year increase of about 15 per cent during 1982.

2.49 The volume of private consumption expenditure is dependent upon the likely trends in real personal income, and in the savings ratio. While some recovery in real agricultural incomes should boost real personal income, the poor employment outlook suggests that there will be little, if any real growth in aggregate incomes. Given the low savings ratios recorded in 1980 and likely to be recorded in 1981, there is little likelihood of any further decline in the savings ratio, which would suggest that private consumption expenditure is unlikely to experience any significant volume growth. Public consumption expenditure is assumed to show no volume increase in 1981 (see 2.47).

2.50 Public capital expenditure is assumed to show no volume increase in 1982, reflecting the "neutral budget" assumptions. Improvement in export demand, and recovery in the agricultural sector should result in a marked expansion in private fixed investment from the low levels recorded in 1980-81. Physical stocks should also increase, as stock levels continue to recover from the destocking of 1980.

2.51 The recovery in Ireland's export markets should provide a strong

stimulus to Irish exports, particularly if market shares for industrial exports can be improved. The heavy destocking of 1980 may provide a constraint on the expansion of agricultural exports, but the forecast decline in such exports in 1981 should be reversed.

2.52 On the basis of past trends, import volumes should increase faster than final demand. The actual scale of the increase is sensitive to the composition of the increase in final demand, and to the success of import-competing domestic industries in satisfying domestic demand. While the responsiveness of imports to final demand should not be as great as in the 1975-77 recovery,⁴⁵ it is likely that imports will increase close to one-and-a-half times as fast as final demand.

Given the likely trends in the components of GDP, discussed above, a tentative forecast would suggest GDP growth in 1982 of 2-2.5 per cent. Given the likelihood of official foreign borrowing in excess of £1,100 million in 1981, a further substantial increase in net factor payments to foreign residents will occur, with the result that GNP growth will be about 1 percentage point less than the increase in GDP. The current account deficit on the balance of payments is likely to increase in nominal terms, and could amount to £1,500 million, over 13 per cent of GNP. This compares with a forecast of approximately £1,375 million for 1981, an estimated 13.8 per cent of GNP. The financing of a deficit of this magnitude will require additional increases in the official external indebtedness.

⁴⁵In 1975-77, imports increased, in volume terms, by 29.2 per cent, compared with a 15.0 per cent increase in final demand.

CHAPTER 3

REVIEW OF SOCIAL POLICY

3.1 The aims and recommendations presented in the final chapter of this report were formulated with regard to the principles of economic and social development. Chapters 1 and 2 include an analysis of the economic environment within which policies must be formulated. Economic policies cannot be considered in isolation from their social impact: policies which aim to affect the level of resources must be accompanied by consideration of the distribution of these resources. This chapter includes a discussion, from a social policy perspective, of recent developments.

3.2 This chapter contains discussion of the following issues:

- recent developments in public expenditure on the social services: housing, education, health and social welfare
- social aspects of unemployment
- distributive consequences of the tax system.

Finally in an addendum to the chapter there is a list of social policy developments which have occurred over the last twelve months.

3.3 The following sections of this report compare the estimates for the principal social services for 1981 with expenditure in recent years. In particular, their relationship to expenditure in 1980 is discussed with reference to implications for availability of services. The Council believes that such an examination is desirable to demonstrate the consequences of the proposed allocation of scarce public funds. (This examination is based on the assumption that estimate figures are intended to represent firm proposals for limits of expenditure).

Second National Understanding

3.4 The Second National Understanding for Economic and Social Development, which was concluded by the Government, employer and industry organisations and the Irish Congress of Trade Unions in October

1980¹ was an important development in social policy in the past year. The National Understanding contained a number of commitments on the part of the Government in relation to social policy, in particular with regard to taxation, health, social welfare, housing, education and training, the disabled and conditions of employment. In some cases, these commitments constituted a reiteration of general principles in regard to the operation of these services, e.g. maintenance and development of community care services; continuing to give attention to the achievement of greater equity in taxation. In other cases, the commitments amounted to an undertaking to review certain areas of policy, e.g. housing finance; family income support (taking account of the relevant NESR reports). In a minority of cases, the commitments were of a specific nature, e.g. to introduce a statutory scheme of paid maternity leave; to provide for a double payment for one week in December 1980 to long-term social welfare recipients.

International Year of Disabled Persons

3.5 1981 was designated as International Year of the Disabled by the United Nations (UN) as a means of promoting full participation in social life and an equitable share in the benefits of economic and social development. The Minister for Health established a National Committee and Advisory Council to promote activities during 1981 in order to create a greater awareness of the needs and potential of the disabled. In its First Report,² the National Committee made a number of recommendations concerning health services, income maintenance, education, employment, housing and recreation for the disabled. Many of those recommendations are similar to those contained in the Council's report on this issue.³ A number of tax allowances available to the disabled were increased in the 1981 Budget while relevant transfer payments were increased by 25 per cent. In addition, Value Added Tax (VAT) was removed from certain aids for the disabled. A number of allowances available to the disabled were substantially increased while the free telephone rental scheme was extended to recipients of the disabled persons' maintenance allowance. The Council welcomes these increases and the commitment by the Government to publish a green paper during 1981 concerning the future development of certain aspects of services for the disabled. Progress has also been made in implementing the Government decision as regards a 3 per cent quota for employment of disabled persons in the Public Service. A number of special competitions

¹ Agricultural interests were not a party to the Understanding.

² National Committee for the International Year of Disabled Persons, *First Report*, (1981).

³ NESR Report No. 50, *Major Issues in Planning Services for Mentally and Physically Handicapped Persons*, (Dublin, 1980).

have been arranged for entry of disabled persons to the Civil Service and it is expected that up to 200 will be recruited from the competitions by the end of 1981. Health boards, local authorities and other State bodies are also arranging to increase the number of disabled persons employed. The Council has already commented that: "if the goal of integration is to be achieved it will necessitate a change of attitude among the general public and will involve an acceptance of the fact that healthy and handicapped persons should live and work side by side".⁴ The Council believes that the activities of statutory and voluntary agencies during this year designed to bring about such a change of attitude are to be commended.

Housing

3.6 The total number of houses completed in recent years is set out in Table 31. The 1980 figure of 27,800 dwellings completed represents the highest level of completions so far achieved. While the number of local authority dwellings completed has remained fairly constant since 1977, local authority houses have been declining as a proportion of total annual house completions. In 1980 local authority dwellings represented 22 per cent of all house completions, compared to 26 per cent in 1977.⁵ Private estate house-building continues to provide by far the largest source of completions.

3.7 Table 32 sets out public capital expenditure on housing in recent years. Public spending on house construction in 1980, at £2,163 million, was 18 per cent higher than had been provided originally in the Public Capital Programme. It represented an increase in nominal terms of £47 million or 28 per cent over expenditure in 1979, equivalent to an increase in real terms of 5.6 per cent. The original 1981 capital allocation to housing would, if fully utilised have represented an increase of 12 per cent in nominal terms over 1980. The major part of this increase was to provide for house purchase grants and loans, including outstanding commitments in relation to the house improvement grants terminated in 1980. Table 33 shows the allocation of public capital expenditure on housing in recent years. The original allocation for new local authority housing in 1981 was £109 million, representing an increase in money terms of 6.8 per cent over 1980. This would have been likely to result in a significant reduction in the rate of completions of local authority houses over the coming year. However, a further £30 million was provided for local authority housing in the budget of July 1981, representing a

⁴ *Ibid*, page 19.

⁵ The level of completions of local authority houses in 1976 and 1977 were uniquely high, representing 33 per cent and 30 per cent respectively of total completions.

significant increase in real terms in resources for this area. As a result, the share of capital expenditure devoted to local authority housing is estimated at 51.3 per cent, compared to 62 per cent in 1976.

3.8 Current public expenditure on housing in 1980 was £64.5 million. This constituted principally a subsidy to local authorities towards the cost of housing for letting. (£2 million was spent on subsidies to building societies in respect of the interest rate structure.) The allocation for 1981, at £68.4 million, represents an increase in nominal terms of 1.5 per cent. As most of this increase is accounted for by the cost of subsidising interest on building society loans, this implies a substantial reduction in the real value of subsidies to local authority tenants. The subsidy benefits local authority tenants whose rents are less than an economic rent. The value of rents and rent subsidies in recent years is set out in Table 34. The value of subsidies to local authority tenants would be greatly increased if economic rents were measured by reference to market rents rather than (up-dated) historic costs of construction. The estimates for spending on subsidies to building societies relate only to the subsidy which applied between 1 June and 30 September 1980. The cost of paying the subsidy announced in May 1981 (to prevent an increase in mortgage interest rates) is not included in this estimate.⁶ The other principal current housing subsidy is the value of tax allowances for mortgage interest payments. This is estimated to have cost £24 million in revenue foregone in the fiscal year 1980/81.⁷

3.9 The waiting list for local authority housing around the country comprises 27,708 approved applicants (i.e. families who have been accepted by local authorities as being in need of adequate housing). The approved list represents more than three families waiting for each local authority vacancy arising annually.⁸ Two-thirds of approved applicants comprise families of three persons or less. (Table 35) The Council notes that an assessment of housing needs is being carried out at present by

⁶The Minister for the Environment announced in July that this subsidy would be terminated on 1 September 1981.

⁷The Council in a previous report (NESC Report No. 23, *Report on Housing Subsidies*) has commented that the largest element of subsidy to owner-occupiers is the cost of the tax exemption of imputed net rent from owner-occupation. The value of tax relief on mortgage interest payments is less than the cost of this exemption since interest relief only benefits those actually purchasing their house and not those who own their house outright. The exemption of most house sales by owner-occupiers from capital-gains-tax and of new houses from stamp duty constitute important tax subsidies of a capital nature.

⁸However, families on the waiting list may also avail themselves of measures designed to facilitate home purchase. As a result of recent changes they may qualify for a loan of £18,000 and receive a mortgage subsidy of £3,000 (over three years), whether or not the house being purchased is newly constructed. These measures are designed to reduce the demand for local authority housing.

the Department of the Environment in conjunction with the relevant local authorities. This assessment will indicate the level of output of local authority housing which is likely to be necessary over the coming years. The Council proposes to comment in a forthcoming report on the implications of demographic change for housing policy. It is unlikely that the need for local authority dwellings will decline in the immediate future. The situation with regard to housing need in Dublin is substantially unchanged since the Council's Report No. 53: annual vacancies (including new dwellings) represent approximately one-third of approved applications. In addition, the number of existing tenants seeking transfers is over 6,000; a substantial proportion of these are living in overcrowded accommodation.

3.10 One of the factors which affects the availability of local authority accommodation to prospective tenants is the extent to which the stock of local authority housing is reduced through sales. In the period 1975 to 1979 inclusive, 33,742 houses were purchased from local authorities. This represented 97 per cent of the total of local authority houses completed in that period. In short, only 3 per cent of local authority houses completed in a five-year period actually represented an increase in the stock of accommodation available for renting by local authorities. However, the bulk of these sales occurred at the beginning of the period and the level of sales in recent years, at approximately 3,000 houses, has represented one-half of local authority completions. This reduction reflects changes in the terms governing the sale of such houses, such that prices to tenants are considerably less generous.

Tenants are subsidised to purchase local authority dwellings in a number of ways: the gross sale price is likely to be somewhat less than the market price; the gross price is reduced by deductions for length of tenancy; the purchaser qualifies for a fixed interest loan. The Council has already commented that "to the extent that the tenants who purchase dwellings are those with relatively higher incomes—and this is likely—then the effects of the sales scheme work in a regressive direction".⁹ In view of the fact that the rate of sales could leave local authorities managing the most unattractive portion of the housing stock, the Council recommended that consideration be given to other means of stimulating owner-occupation, while retaining the stock of local authority dwellings for the aims of public housing policy. While recognising the benefits which may result from sales of local authority houses,¹⁰ the Council repeats its concern at the effects of local authority

⁹NESC Report No. 23, *Report on Housing Subsidies*, (Dublin, 1977), paragraph 27.

¹⁰These include: revenue to local authorities from the proceeds of sales, reductions in the cost of maintenance, the reduction of social segregation by area of residence and possibly greater variation in the physical appearance of estates.

house sales. It welcomes the introduction of a loan and mortgage subsidy scheme announced in May 1981¹¹ in place of the low-rise mortgage scheme and believes that the further development of these incentives, for purchase of private houses, which are available to existing and prospective local authority tenants, constitutes an alternative to the continuation of local authority house sales.¹² The Council recommends that the implications of the current policy of sales of local authority houses for the size and composition of the public housing stock be kept under review.

3.11 The difficulties facing first-time house purchasers were the subject of measures announced in April 1981 by the Minister for the Environment. The Council notes that the Government undertook to review all relevant aspects of the SDA and low-rise mortgage schemes, as well as to examine the general question of house purchase finance, in the Second National Understanding. The income limit for the SDA loan was increased from £5,500 to £7,000. The latter figure represents rather more than estimated average industrial earnings in 1980/81 (the relevant tax year). The ordinary maximum loan limit was raised from £12,000 to £14,000. While this increase is welcome (the maximum has been increased by 200 per cent since 1977), the maximum loan (£14,000) represents only 65 per cent of the average price of new houses approved for local authority loans in the first quarter of 1981.¹³ While the increase in the maximum loan (and the new mortgage subsidy) are a welcome improvement in the support available to home purchasers on low incomes, the financing of the balance of the cost of a house will continue to be a major difficulty for eligible persons. A higher maximum loan (£18,000) of up to 98 per cent of the net market value of a private house is available to those who were formerly eligible for the low-rise mortgage scheme. In such cases the new mortgage subsidy (discussed below) is payable in respect of previously occupied as well as new houses.

3.12 The principal innovation in the measures announced recently is the introduction of a mortgage subsidy of £3,000 to first-time purchasers of grant-sized new houses, in addition to the existing £1,000 grant. The new subsidy is payable in arrears over three years. The income tax

¹¹The new arrangements include the granting of a mortgage of up to £18,000 or 98 per cent of the cost of a house to existing or prospective local authority tenants and the payment of a mortgage subsidy of £3,000 over three years, payable in such cases in respect of previously occupied as well as new houses.

¹²The Council recognises, however, that not all tenants who purchase a local authority house under the sales scheme would be likely to purchase a private house instead, even with the subsidies now available.

¹³The maximum loan represents 78 per cent of the average cost of new and second-hand houses approved for loans in the first quarter of 1981.

relief gained on mortgage interest payments added to the value of the subsidy may not exceed the amount of the annual loan repayments. On the assumption that purchasers are able to borrow, on a short-term basis, an amount equal to the subsidy in the first year, the latter's impact is likely to be greatest in reducing the burden of raising a deposit for a new house. Table 36 shows the deposit required on an average priced new house financed by a building society mortgage if the purchaser received a loan equal to 90 per cent of the house price.¹⁴ It is estimated that the average deposit in 1980, net of the £1,000 grant for a first-time owner-occupier was £1,799. This amount, equal to 6.4 per cent of the total cost of the house, was just over 30 per cent of gross average male industrial earnings. If the £1,500 available in the first year under the new mortgage subsidy is used to finance a deposit, the net deposit required on similar new houses at prices obtaining in the first quarter of 1981 would be £518.

3.13 The second main obstacle facing prospective house-purchasers is the level of repayments. Table 37 shows the initial repayments to building societies for mortgages on average priced new houses. The gross monthly repayments on such houses for which loans were approved in the first quarter of 1981 is £283. The net repayments are determined by the impact of tax relief on interest paid and the new mortgage subsidy. The impact of tax relief depends upon the borrower's marginal rate of tax: for those liable at the standard rate (35%) the repayments are reduced to £184 monthly, while they are reduced to £113 for those liable at the maximum rate of 60 per cent.¹⁵ The latter group are more likely to use the new mortgage subsidy to offset repayments than to finance the deposit (as assumed in the previous paragraph). In that case, they would have no repayments in the first year. Table 38 illustrates the net repayments in the first three years for borrowers (at current rates and prices) with differing marginal tax rates. The new mortgage subsidy, is, of itself, progressive since it is of more benefit (proportionately) to lower income groups because of its flat-rate character. However, the regressive effects of the subsidies available through the tax system continue to operate in conjunction with the new subsidy, i.e. those on higher incomes receive the highest levels of subsidy.

3.14 The Council is concerned that the new subsidy further accentuates the benefits available to the higher income groups in the housing

¹⁴Such loans are available from a number of building societies to first-time house purchasers whose incomes are sufficiently high to meet the cost of servicing the mortgage.

¹⁵A married couple (both working) are liable to tax at 60 per cent on gross incomes in excess of £22,430 (excluding non-personal allowances and deductions). Such joint income would be relatively unusual among first-time buyers.

market and that no attempt was made to concentrate the benefits on those most in need, even within the house purchasing sector by, for example, off-setting the subsidy against tax relief or making the subsidy taxable.¹⁶ The new subsidy will cost approximately £22 million per year when fully in operation. As an indicator of the range of choice available in the allocation of funds, it is noteworthy that this would finance approximately 950 local authority dwellings (at 1980 prices) or would enable an income-related subsidy to be introduced for private tenants who currently receive no subsidies but who include the poorest groups in the community.¹⁷ The Council, in a report on priorities in social policy,¹⁸ has recommended that priority be given to policies which are directed to those most in need. The distributive impact of proposals for new expenditure programmes should be published to indicate progress in that regard. While the latter requirement was not met in this case, the Council believes that, in the light of the evidence available to it, the new mortgage subsidy does not represent a priority use of scarce public funds within the housing area.

3.15 The Council is also concerned that the new mortgage subsidy may not be wholly reflected in a reduction in the cost of houses to first-time buyers. The supply of housing is slow to respond to increases in demand or price because of locational fixity and the length of time required to complete new houses. A stimulus to demand for housing is therefore more likely to be reflected in the short term in increased prices rather than output. The operation of the CRV scheme does, however, represent a means of controlling such increases. In 1977, the introduction of the £1,000 grant for first-time purchasers and the abolition of domestic rates gave a significant boost to demand for houses. Completions of private sector dwellings increased by 8.8 per cent in 1977 and by a further 6.3 per cent in 1978. However, the average price of new houses increased by 19 per cent in 1977 and by a further 29.2 per cent in 1978. In 1978, house prices increased nearly four times as fast as consumer prices whereas they had increased only by rather less than one-fifth faster than consumer prices, on average, in the previous four years. Similarly, in 1978 new house prices rose on average by more than twice the increase in average adult earnings, whereas the increase in the previous four years was approximately equal

¹⁶The Minister for the Environment announced in July 1981 that the subsidy would be confined to married couples, those about to marry and certain categories of single persons who are considered to be in housing need.

¹⁷However, a payment in respect of rent may be made to those who qualify for a Supplementary Welfare Allowance.

¹⁸NESC Report No. 61, *Irish Social Policies: Priorities for Future Development*, forthcoming.

to the average rise in adult earnings. While other factors clearly influence the level of new house prices, it is likely that a stimulus to demand in the absence of measures to increase building output will lead to pressure for price increases which, if they occurred, would reduce the impact of subsidies. The Council notes, however, that the CRV scheme has been substantially modified and placed on a statutory basis since 1977 and may thus prove to be a more effective method to controlling the pressure for house price increases.

3.16 The Council is very concerned that no decisions have yet been taken on the issues relating to the control of the price of building land. This matter is of great importance for the cost of providing accommodation in both the public and private sectors and also for equity in the distribution of income and wealth. The Council, in last year's report¹⁹ stated that sufficient time had been devoted to the examination of the recommendations in the *Kenny Report* for policy decisions to be taken. Since the *Kenny Report* was published in 1974, the price of land for housing acquired by local authorities in or adjacent to urban areas has increased from an average of £2,638 per acre (1975) to £6,811 (1980), an increase of 158 per cent. While this is substantially less than the increase in the average price of new houses over the same period, the lack of progress on this issue is to be deplored on the grounds of equity and the Council urges that action be taken as a matter of urgency.²⁰

3.17 The Council wishes to record its concern at the distributive impact of recent developments in housing policy. As was demonstrated in previous paragraphs, the proportion of new houses constructed by local authorities has declined significantly in recent years as the number completed annually has been held constant; the proportion of the public capital expenditure devoted to public housing has declined at the expense of subsidies to owner-occupiers; the average level of subsidy of local authority tenants has declined in real terms while substantial increases in the subsidies available to house purchasers have been announced. While the Council welcomes the increase in the level of house construction and efforts to ease the burden of house purchase, in particular for those who might otherwise be obliged to seek local authority housing, it believes that the distributive impact of these measures and the adequacy of public policy in respect of those in

¹⁹NESC Report No. 53, *Economic and Social Policy 1980-83: Aims and Recommendations*, (Dublin, 1980).

²⁰A commitment to "reach firm decisions as soon as possible on the actions to be taken so as to curb the rising costs of development land" was given by the Government in the Second National Understanding.

greatest need are of the greatest importance. The Council recommends that future developments with regard to housing subsidies should be directed towards producing a more equitable outcome. In this context, the Council believes that the policy options outlined in Report No. 23²¹ are still worthy of examination.

3.18 With regard to special housing needs, the Council welcomes the increase in grants to disabled persons for alterations and reconstruction, to £4,000, announced in April 1981. This represented an increase of 66.66 per cent. The Council notes that the number of houses provided for elderly persons by local authorities in recent years has exceeded the level of 10 per cent of all local authority dwellings recommended in *The Care of the Aged* report in 1968. The Council welcomes this level of provision and recommends that construction of housing for the elderly, in particular of sheltered housing schemes, continue to receive a high priority. The Council notes with concern the results of a survey of old people living alone conducted by the Society of St Vincent de Paul in 1978,²² which found that 30 per cent of old people living alone had none of the basic water amenities²³ for their sole personal use. In addition, 10 per cent of residents had no electricity supply. Old dwellings, principally in rural areas, accounted for many of these cases. Furthermore, 20 per cent of respondents complained of persistent, frequent or recurrent dampness while 25 per cent complained of draughts. This evidence suggests that a significant minority of the elderly living in the oldest part of the housing stock suffer substantial housing deprivation. The Council believes that a policy on the rehabilitation and improvement of older dwellings is necessary and recommends that consideration be given to the introduction of a modified version of the scheme of home improvement grants discontinued in 1980.²⁴ Voluntary and community organisations would have an important role in ensuring that groups like the elderly availed themselves of such aid. The Council welcomes the increase in maximum loans and subsidies to voluntary groups providing housing for the elderly and the extension of these aids to voluntary housing for other groups in need.

²¹NESC Report No. 23.

²²Society of St Vincent de Paul, *Old and Alone in Ireland*, (Dublin 1980).

²³These are a hot water supply, a bath or shower, a wash-hand basin, a flush toilet and a kitchen sink.

²⁴The Council notes that the limit of expenditure under the essential repairs grant scheme has been increased to £2,000 while new arrangements have been made for the financing of house improvement works by local authorities. Provision was made in the July 1981 Budget for a new scheme of house improvement grants to be announced by the Minister for State of the Department of the Environment.

Education

3.19 The position regarding public capital expenditure on education is set out in Table 39. The outturn of capital expenditure in 1980, at £61 million, was 20 per cent higher than had been provided originally in the Public Capital Programme. The original estimates had provided for a substantial fall in expenditure on this heading, in nominal terms over 1979; supplementary estimates resulted in the outturn exceeding 1979 expenditure by 14.5 per cent in nominal terms. This was equivalent to a reduction of 5.5 per cent in real terms. The reduction in real terms in capital spending in both 1979 and 1980 will not continue in 1981: the Public Capital Programme provides for expenditure of £80 million, which represents an increase in real terms. The extent to which capital spending over a period of years represents the achievement of policy goals for provision of accommodation can only be assessed in the light of analysis of pupil enrolment by age, sector and region. This is discussed below in the context of the White Paper on Educational Development.

3.20 Current public expenditure on education is set out in Table 40. The outturn in 1980, at £486 million, was 6 per cent greater than had been estimated originally. The over-run was due mainly to pay increases. There was no change in real terms in current spending in 1980 as compared with 1979. The estimate for current spending on education in 1981, at £601 million, is 24 per cent higher than the outturn for 1980. This is likely to result in an increase in real terms of the order of 4 per cent.²⁵

3.21 *The White Paper on Educational Development* was published in December, 1980. The Council welcomes the publication of such policy statements as an integral part of the process of planning and evaluation in the social area. It regrets that they are not a more regular feature of social policy development. The Council proposes to comment further on this issue in a forthcoming report on social planning.

3.22 The White Paper contains projections of student numbers in the period to 1991 and consequent implications for numbers of teachers and building requirements. The number of additional pupils in each level and the projected requirements of additional teachers and accommodation for the coming decade are set out in Table 41. The rate of increase in numbers of pupils in national schools is likely to be roughly equivalent to the rate experienced over the last decade. However, a substantially increased level of replacement of out-of-date or pre-

²⁵An additional £2.25 million was provided in the July 1981 Budget to meet the cost of increased grants for third level students which were announced by the Minister for Education.

fabricated structures is foreseen at primary level. The projected number of teachers required implies a marginal decline in the average number of pupils per class (from 28.1 in 1980/81 to 27 in 1991). This does not necessarily imply a decline in the number of pupils in large classes, which is generally held to be excessive. The rate of increase in enrolments in second-level schools, at 10.5 per cent for the coming decade, is estimated to be substantially lower than over the past 15 years. Comprehensive and community schools are likely to be the fastest growing component of the system. A substantial building programme will be necessary to provide over 60,000 additional places over the decade, including the replacement of obsolete accommodation. The substantial increase projected in the numbers in third level education will be concentrated in the vocational sector, including the proposed regional technical colleges in Dublin, and the National Institute for Higher Education. The projected building programme at third level, while smaller than for the other sectors is likely to be quite expensive because of the greater importance and sophistication of equipment and infrastructural support in this sector.

3.23 The White Paper does not contain estimates of the cost of providing the additional places required or the costs of employing additional staff as projected. It does state that the building programme will proceed subject to the availability of resources. The Council regrets that the opportunity was not taken in the White Paper to identify the costs likely to arise from the projected increase in student numbers (as well as from other trends and proposals outlined). The Council has already recommended: "when any new proposal for public expenditure is made, its costs should be projected forward for five years so that the public will be made aware of its cost implications. These projections would help to ensure that the growth in public expenditure was related to the capacity and willingness of the community to finance them".²⁶ The Council is aware that some of the proposals in the White Paper do not readily allow of precise quantification of costs. However, the Council notes that the Minister for Education has stated that the capital and teaching costs can be readily inferred from the White Paper.²⁷ Estimates of the cost of providing necessary buildings and additional teachers were sought from the Department of Education and these are set out in Table 42. The Council believes that it would have been preferable to have these estimates included and discussed in the White Paper. This is all the more desirable in view of the fact that these estimates imply, for example, an increase in real terms of 20 per cent, on average, in current

²⁶ NES Report No. 21, *Report on Public Expenditure*, (Dublin, 1976), paragraph 6.32.

²⁷ *Dail Debates*, Column 737, 3 February 1981.

spending to meet the costs of employing additional teachers.

The Council proposes to return to this question in a forthcoming report on the implications of demographic change for the social services.

3.24 The Council welcomes the acknowledgement in the White Paper of the importance of equality of opportunity within the educational system and the need, in particular, for curriculum development and teacher education to respond adequately to the educational needs of disadvantaged children. The Council notes and welcomes the statement that "special educational intervention, however sensitive, can hardly achieve its objectives unless accompanied by significant changes in the children's life-experience as a whole. The Government will be concerned to ensure that educational change will be accompanied by a comparable amelioration of the environmental circumstances which at present militate against successful school performance".²⁸ It is regrettable that the White Paper does not indicate what measures will be taken to bring about such amelioration.

3.25 The Council notes and endorses the White Paper's statement of the standards and competences required of pupils in second-level education: "that pupils be well-trained in various forms of thinking, in spoken, written and artistic expression, in scientific method, in manual dexterity, in acceptable forms of social behaviour and the exercise of social responsibilities".²⁹ The need to prepare young people for the world of work requires "an adequate articulation between the education system and the economy".³⁰ The Council welcomes the proposal for greater diversification in the curriculum at second-level, with particular reference to technological skills appropriate to the modern economy with its emphasis on new forms of information handling and communications. In particular, the Council welcomes the proposal to develop alternative courses designed to provide young workers with basic career skills, through work experience and allied instruction. The further development of these alternative approaches at second level, with elements of general education and personal and social development, is particularly welcome as an attempt to cater more effectively for the needs of pupils who are likely to leave whole-time education at a relatively early point, and may, indeed, encourage such pupils to remain in the educational system.

²⁸ White Paper on Educational Development, paragraph 4.16.

²⁹ *Ibid.*, paragraph 6.21.

³⁰ *Ibid.*, paragraph 6.13.

3.26 With regard to third-level education, the Council notes the statement in the White Paper calling for flexibility and diversification both within and between educational institutions, in particular with a view to meeting vocational needs in the community. The Council welcomes the proposals to expand provision for certificate and diploma level courses and to expand engineering education in the universities and the non-university sector, at various levels.

3.27 The Council is disappointed that the White Paper contains little reference to issues which it believes are of particular concern in the area of education. The Council has already recommended³¹ that priority be given to increased expenditure on the compulsory education age group as this would do most to promote equality of opportunity in education. The White Paper does not refer to the issue of low rates of participation by children of low-income families beyond the minimum school-leaving age. It does not specify how the educational attainment of disadvantaged children will be improved. The Council believes that the development of more equitable participation rates should constitute an over-riding aim of social policy, and this should be reflected in a document discussing policy for the period of a decade.

Furthermore, the distributive impact of educational expenditure on different income groups is not discussed in the context of existing or future financing arrangements. Such distributive consequences are at the heart of social policy and merit serious discussion in any statement of public policy.

Health

3.28 The position concerning public capital expenditure on the health services is set out in Table 43. Expenditure in 1980, at £35 million, was 25 per cent higher than had originally been estimated. The increases were due to the effects of inflation on the health construction programme and an unexpectedly high level of output in what had been intended as a restricted capital programme. The outturn was 27 per cent higher in nominal terms than capital spending in 1979. The increase in real terms of 5 per cent continued the trend of increased capital spending on the health services, largely as a result of the programme of development of general hospitals. Capital spending in 1981 is estimated at £47 million, an increase of 34 per cent in nominal terms. This is equivalent to an increase in real terms of over 12 per cent and, if adhered to, will result in an increase in the rate of completion of building projects.

³¹ NESC Report No. 12, *Educational Expenditure in Ireland*, (Dublin, 1976).

3.29 Table 44 outlines the position regarding public current expenditure on health services. The outturn for net expenditure in 1980 was £701 million. As £35 million of this was a non-recurring provision for salary increases back-dated to 1979, the level of expenditure related to 1980 was £666 million. This outturn for 1980 showed an increase of £128 million or 22 per cent as compared with the budget estimate. The increase was due largely to substantial pay awards, principally to nursing staff. The increase would have been higher but for the fact that appropriations-in-aid in the health services in 1980, at £52.8 million, were 23 per cent higher than had originally been estimated, mainly due to increased yield from health contributions occasioned by increases in average incomes. The expenditure level of £666 million for 1980 was an increase of 23 per cent in nominal terms over expenditure in 1979 which was equivalent to a modest increase in real terms, e.g. new units were commissioned and other service developments occurred.³²

3.30 Non-capital spending on statutory health services in 1981 is estimated at £773 million, an increase in nominal terms of 16 per cent over 1980. This provision is likely to represent a slight decrease in spending in real terms. The rate of increase in public spending in real terms on the health services has been significant in recent years and in such circumstances particular policies and services may develop rapidly. The evaluation of existing policy and services to ensure that the highest possible levels of cost-effectiveness are achieved should therefore receive high priority. The Council notes, for example, the publication of a recent report³³ which suggests that substantial savings could be effected through changes in arrangements for the supply of drugs and medicines, the cost of which has increased substantially in recent years. A constraint on the scope for effecting reductions in spending on non-capital health services, however, is their labour intensive character: nearly 70 per cent of non-capital health expenditure in 1981 is estimated to be required for pay purposes. Table 53 illustrates the trend in staff costs in recent years. A concern to ensure the cost-effectiveness of health spending must, therefore, be reflected in a review of the numbers and productivity of staff employed.

3.31 Table 45 sets out the percentage breakdown of current expenditure on the health services by programme. The table illustrates that

³² However, when deflated by the deflator for net current public expenditure no increase in real terms would be shown. This implies that a more refined deflator for the health services is required to reveal small changes in real expenditure. Such a deflator is not available.

³³ Report on the *Review of Arrangements for the Supply of Drugs and Medicines*, Report by Trident Management Consultants for the Department of Health, (Dublin, 1981).

spending on hospital services in recent years has increased relative to spending on community services. The continued growth of expenditure on general hospital services, in relative terms, reflects the numbers of patients treated annually and associated costs of staff and equipment, as well as the greater impact of pay awards on hospital costs than in community services due to the relatively larger number of personnel employed in hospitals. The Council is concerned that, within expenditure on the community services, expenditure on home help and meals-on-wheels services, together with grants for voluntary agencies should not be allowed to decline. These services are vital for the well-being of many vulnerable groups, particularly the elderly, but their level of provision is generally determined by administrative decision rather than by statutory entitlement. Given the extent of committed expenditure on staff and accommodation costs, the burden of reductions in real spending may fall disproportionately on these services. The Council is concerned that any reduction in real terms in this form of expenditure might increase the demand for costly and unnecessary institutional care. The Council notes the Government's commitment, in the Second National Understanding, to the maintenance and development of the community care and welfare programmes under health boards.

Social Welfare

3.32 Current public expenditure on social welfare is set out in Table 46. Exchequer expenditure in 1980, at £493 million, was 39 per cent higher than had originally been estimated. The over-run was due to the cost of paying the increases in allowances provided for in the 1980 Budget and also the cost of paying an extra week's allowance to recipients of long-term benefits in December 1980. Contributions to the social insurance fund by employers and employees were also lower than had been estimated. Total public expenditure on social welfare, including expenditure from the social insurance fund, at £890 million was 30 per cent higher in nominal terms than in 1979. Using the deflator of net current expenditure by public authorities, it can be seen that a substantial real increase in expenditure occurred in 1980, following a period of stability since 1976.³⁴ Using changes in the consumer price index to deflate expenditure a similar increase in real terms can be seen in 1980. Allowance must, however, be made for the changing number of beneficiaries. The number of beneficiaries is particularly influenced by cyclical factors, principally through the impact of unemployment.

³⁴ Volume changes have been calculated by reference to the deflator for net current expenditure by public authorities and to changes in the consumer price index. The latter deflator is more appropriate if it is intended to measure the value of transfer payments to the recipient.

3.33 Social welfare expenditure is determined by the number of eligible persons who apply for benefits and allowances. Cyclical factors influence the levels of expenditure through the number of unemployed persons and the average duration of unemployment. Table 47 sets out the number of recipients of unemployment benefit and assistance in recent years and the level of expenditure on benefits paid to the unemployed. The proportion of social welfare expenditure accounted for by unemployment payments was less in 1980 (16.6%) than in 1976 (18.6%). The relative value of such payments as well as the numbers in receipt of these payments will determine their share of total expenditure. Unemployment benefit and assistance are regarded as short-term payments and have therefore been increased by 20 per cent in recent budgets, compared to 25 per cent for long-term benefits.

3.34 Table 48 shows the allocation of social welfare income and expenditure in 1980. The importance of exchequer financing is apparent and this is relatively high by European standards. The trend in recent years has been for the share of expenditure met from employees' social insurance contributions to fall, while the share derived from employers' contributions has risen and the Exchequer contribution has remained constant.

3.35 The Council welcomes the increase in the value of benefits and allowances provided in the 1981 Budget. The value of short-term allowances, other than child dependant payments were increased by 20 per cent while those of a long-term nature were increased by 25 per cent.³⁵ The Council notes that the Minister for Social Welfare has publicly endorsed the Council's statement in Report No. 53 that those most in need must not suffer from changing economic fortunes over which they are powerless.³⁶ The Council welcomes the increases as an attempt to meet this criterion. However, the Council is disappointed that the increase in allowances for child dependants in the social welfare code were, at 10 per cent on average, considerably less than the projected rate of inflation for 1981.³⁷ Children's allowances were, however, substantially increased: by one-third for the first child and by 29 per cent for subsequent children, with effect from July 1981. The combined effect of the increases in children's allowances and child dependant

³⁵ In the July 1981 Budget rates of benefit were increased for old age pensioners (and other recipients aged 66 or over) by 5 per cent and for all other recipients by 3 per cent, with effect from October 1981. No distinction was drawn between long and short-term payments other than to the elderly.

³⁶ *Dail Debates*, Column 705, 29 January 1981.

³⁷ Dependant allowances were increased in the July 1981 Budget by 5 per cent (Dependants of recipients aged 66 or over) or 3 per cent (all others).

allowances is that the monthly income of a married couple with two children dependent on unemployment benefit (flat-rate) increased by 18 per cent from July, compared with the 20 per cent increase in basic rates. Similar families dependent on invalidity benefit had an increase of 22 per cent, compared with 25 per cent in basic rates introduced in April. The Council welcomes these substantial improvements as an advance towards a more adequate level of family income support. However, in view of the fact that the children of those dependent on social welfare payments are among the most deprived groups in the community, the Council believes that the value of child dependant allowances should at least have been maintained in real terms.

3.36 The Pilot Scheme to Combat Poverty, initiated in 1974, came to an end in December 1980.³⁸ The Council notes that the final report of the National Committee responsible for the pilot scheme and the projects themselves together with other relevant material are under examination by an inter-Departmental group with a view to determining what further action may be taken. The Council welcomes the commitment in principle by the Government in the Second National Understanding to develop a sound and effective approach to the tackling of poverty including research projects, where appropriate.³⁹

3.37 The Council notes with concern the serious delays which have occurred in recent months in the payment of disability benefits. The delays, consequent on a changeover from social insurance numbers to revenue and social insurance (RSI) numbers for benefit payment purposes and the failure of many applicants to quote their old and new record numbers on applications, have been largely eliminated. The administration of income maintenance payments must be capable of providing an accessible and efficient service to those dependent on such payments. Even short delays in the receipt of entitlements can cause considerable distress. The Council recognises that the recent changeover was necessary and that the serious delays were of a temporary nature. However, the Council is concerned that the degree of centralisation of administration of the social welfare system may have aggravated the situation and may, in general terms, make for an inflexible service. The Council therefore recommends that consideration be given to a restructuring of the administrative arrangements in favour of a decentralised system, with a greater degree of access at local level. Arrangements should be capable of being devised which would enable entitlement to

³⁸The total cost of the National Committee and projects in the seven years, 1974-80 inclusive, was £2.4 million, of which 35 per cent was contributed by the EEC Commission.

³⁹Provision was made in the July 1981 Budget for a new structure to be established to carry forward the work of the Combat Poverty team.

be determined and payments made at a regional or local level while central monitoring and control could continue, based on modern data handling procedures.

Social Spending 1981

3.38 The overall position regarding public social expenditure is set out in Table 49. Current social spending in 1981 is estimated to represent 44.6 per cent of current Government expenditure, compared with 44.8 per cent in 1980 and an average of 45.4 per cent in the five-year period 1976-80. Capital expenditure on the social services in 1981 is estimated to represent 21.2 per cent of spending on the Public Capital Programme, compared with 23.5 per cent in 1980 and an average of 24.5 per cent in the period 1976-80. The total of public current and capital social expenditure in 1976 represented 26.6 per cent of GNP, in 1980 it is provisionally estimated at 23.5 per cent of GNP and, in 1981, at 23.1 per cent.⁴⁰

3.39 There was a small decline in the proportion of public current and capital expenditure devoted to the social services in 1980 and this is likely to continue in 1981. However, in absolute terms, the level of social spending is high and represents a substantial proportion of the output of the community. In view of our unique demographic structure it is to be expected that a high proportion of our output should be devoted to the provision of social services, in addition to transfer payments to dependent groups. However, the high levels of social spending in recent years have coincided with increasing deficits on current public expenditure. (see Table 20) The implication of this level of deficit is that the community has borrowed heavily to pay for the public spending, including social spending, which it desires. The importance of eliminating the current budget deficit is discussed in the following chapters. Insofar as this may require a reduction in the level or rate of growth of public expenditure, the burden of adjustment should not fall on those vulnerable sectors of the community who are dependent on social services and transfer payments.

3.40 In a previous report, the Council has stated its belief that:

"levels of support for those most in need and the degree of redistribution within the community should at least be maintained in times of economic difficulty. It follows that in periods of recession, those in employment or otherwise in receipt of a

⁴⁰Budget Book, various years.

secure income have an even greater obligation to contribute to the support of those in need through taxation".⁴¹

The manner in which revenue is raised to meet expenditure commitments, including additional revenue which may be required to eliminate the current budget deficit, has substantial implications for the distribution of disposable income in the community. The distributive consequences of the tax system are therefore of equal concern as the provision of social services for the attainment of the objectives of social policy.

3.41 The distributive consequences of the system of allowances and deductions within the income tax system—generally designated as fiscal welfare—is of particular concern. Table 50 sets out the cost in terms of revenue foregone of the principal allowances and reliefs in the income tax system. The value of tax allowances and reliefs to the individual tax-payer is determined by his marginal tax rate, as well as the nominal value of the allowance or relief. Thus, the fall in the cost of the personal allowances in 1980/81 as compared with 1979/80 reflects the introduction of income-splitting for married couples in 1980 which had the effect of doubling the tax bands. The total value of allowances and reliefs is substantial, particularly in comparison to the amount of public expenditure devoted to programmes with similar aims. Thus, for example, the cost of child tax allowances and relief of social welfare children's allowances was £58 million in 1980/81, which was equivalent to 78 per cent of the cost of paying children's allowances in 1980. The cost of relief of employees' superannuation contributions was £14 million in 1980/81, which was equivalent to 54 per cent of the Exchequer contribution to the cost of paying social insurance (contributory) old-age pensions in 1980. Concern at the rate of increase of public expenditure on the social services may not take account of increases in the value of related tax allowances, which have similar implications for the public finances. For example, the estimated cost of tax relief on medical insurance *premia* rose by 25 per cent between 1979/80 and 1980/81, while Government current expenditure on the health services increased by 23 per cent between 1979 and 1980.

3.42 The Council in a previous report⁴² has recommended that the distributive impact of tax allowances and reliefs should receive greater attention in the development of social policy. In that report it was indicated that higher income groups benefitted disproportionately

⁴¹NESC Report No. 61, paragraph 5.3.

⁴²NESC Report No. 61.

from such allowances, partly due to the structure of the tax system but also because certain expenditures for which tax relief may be claimed are more likely to be incurred by those on higher incomes. The Council recommended that the benefits of tax allowances should not flow disproportionately to the higher income groups. In addition, it questioned the desirability of continuing the tax relief of medical insurance *premia* in view of current eligibility for health services free at the point of use. In an earlier report⁴³ the Council outlined possible methods of limiting the extent of the tax relief on mortgage interest payments which at present is of most benefit to those on higher incomes purchasing more expensive houses. The Council believes that these issues merit serious consideration in view of their implication for social equity.

3.43 Earnings, together with the taxation and transfer systems, determine the disposable income of families. Given the importance of redistribution for the attainment of social policy objectives, it is necessary that the overall impact of taxes and transfers should be progressive, i.e. transfer resources from higher to lower income families. An examination of their distributive effects in 1973 has been published and showed the extent of redistribution at different levels of income.⁴⁴ The Council has recommended that a similar analysis, based on the Household Budget Survey of 1979 be prepared and published before the end of 1982.⁴⁵ As an indicator of recent developments in the area of redistribution, Appendix 4 sets out the effects of direct taxes and transfers on the income of a number of prototypical families in the years 1976/77 to 1980/81. Their effects are summarised in Tables 51 and 52. It will be noted that the gap between the disposable income of those on high incomes and those in receipt of average industrial earnings widened considerably as a result of the introduction of income-splitting for tax purposes in the 1980 budget. The disposable income of families on unemployment benefit, while relatively improved in 1980, is still substantially below that necessary to support typical patterns of consumption in the community, i.e. those of the average production worker. The distributive impact of public expenditure on benefits in kind must however be taken into account before an assessment of the overall distributive impact of public policy is possible. Such analysis

⁴³NESC Report No. 23.

⁴⁴*Redistributive Effects of State Taxes and Benefits on Household Incomes in 1973*, CSO 1980. This analysis is, however, subject to the limitations of all household budget surveys, i.e. understatement of income, which may have the effect of over stating the extent of the regressivity of indirect taxation.

⁴⁵NESC Report No. 61, paragraph 5.4.

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⁴³NESC Report No. 23.

⁴⁴*Redistributive Effects of State Taxes and Benefits on Household Incomes in 1973*, CSO 1980. This analysis is, however, subject to the limitations of all household budget surveys, i.e. understatement of income, which may have the effect of over stating the extent of the regressivity of indirect taxation.

⁴⁵NESC Report No. 61, paragraph 5.4.

constitutes a basic requirement for the assessment of the extent to which social policy objectives are being met.

Unemployment

3.44 The extent of the problem of unemployment has been outlined in Chapter 1. It is estimated that the rate of unemployment in April 1981, including school-leavers seeking work for the first time, was 9.3 per cent. The outlook for employment and unemployment in the context of overall economic policy is discussed in Chapter 4. From the social policy perspective, unemployment constitutes one of the most important causes of social distress in terms of material deprivation and lack of social status. The Council is therefore concerned that the level of income received by families whose breadwinner is unemployed should be adequate and that the distribution of the burden of unemployment should not be permitted to aggravate the extent of inequality within the community.

3.45 While statistical information on the characteristics of the unemployed does not extend to an adequate account of their social background, it is clear that unskilled and semi-skilled workers are more likely to become unemployed than other members of the labour force. They are likely to be restricted to lower paid occupations and, having limited educational attainment, are likely to have been raised themselves in low income families. It is also known that older workers on becoming unemployed are less likely to be re-employed. In the course of a recession, the employment prospects of the lower skilled and the older worker are aggravated by the fact that younger and skilled workers are able to compete more successfully for available jobs. There is thus a need for greatly intensified efforts to make appropriate arrangements for the training of these vulnerable groups of unemployed.⁴⁶

3.46 Not all of the unemployed receive transfer payments from public funds. Those who have no entitlement to social insurance benefits may not qualify for a means-tested assistance payment. School-leavers and married women are the principal groups in this category.⁴⁷ The level of payments to those who do qualify for transfer payments has been the subject of comment suggesting that these payments are unduly high and encourage people to remain unemployed. Such conclusions are hardly supported by the available evidence. In one particular week

⁴⁶The Council recognises the difficulty which exists in persuading many of this group, particularly older workers, to participate in retraining programmes.

⁴⁷These groups are unlikely to register at employment exchanges and are under-represented on the Live Register.

in 1980,⁴⁸ 86,600 people qualified for payment of unemployment benefit or assistance.⁴⁹ The rates of payment in June 1980 were as follows:

<i>Unemployment Benefit</i>		<i>Unemployment Assistance</i>	
Single Person	£20.45	Single Person	£17.00
Married Couple	£33.70	Married Couple	£29.25
+ 1 child	£39.65	+ 1 child	£34.55
+ 2 children	£45.60	+ 2 children	£39.85

Table 53 outlines the numbers who qualified for various types of payment. 51 per cent received unemployment benefit, while 23 per cent received pay-related benefit in addition to unemployment benefit. 43 per cent of the recipients of unemployment benefit had an adult dependant and an average of two child dependants. The transfers received by a typical family dependent on unemployment benefit were thus £45.60 per week. The minority in receipt of pay-related benefit received an average of £16 in addition.

3.47 Just under half of the unemployed in receipt of unemployment payments were not eligible for, or had exhausted their entitlement to unemployment benefit. The majority of these recipients of unemployment assistance were single and received a maximum income (dependent on their assessed means) of £17 weekly. However, 46 per cent of recipients had an adult dependant and an average of three child dependants. These families had a maximum payment of £43.95 per week. Such a family dependent on unemployment assistance had a maximum income equivalent to 31 per cent of average male industrial earnings in June 1980 (single people received a maximum of 15 per cent of that income). The typical family in receipt of unemployment benefit had an income equivalent to 41 per cent of average male industrial earnings in June 1980. For the minority in receipt of pay-related benefit, their average income was raised to 55 per cent of that level. The income available to the unemployed in most cases is thus unlikely to constitute of itself a significant inducement to forego for long available opportunities for employment. The Council, rather, is concerned at the low level of payments to families dependent, in particular, on unemployment assistance, and the levels of deprivation which these imply since the majority of these are long-term unemployed.

3.48 A further determinant of the adequacy of payments to the

⁴⁸Week ending 27 June 1980.

⁴⁹Other than small-holders.

unemployed is the duration of unemployment. The longer a person is unemployed, the more likely it is that his savings will have been exhausted, while the need to replace clothing and other semi-durable goods will increase. Thus a weekly level of income which is adequate in the short-term may be quite inadequate over a long period. While the majority of the unemployed are short-term recipients of unemployment payments, a significant minority of families are dependent on such payments over a long period. Furthermore, the longer the duration of unemployment, the less likely a person will return to gainful employment. Thus, in November 1979 (the latest date for which statistics are available) 31 per cent of unemployed males had been on the live register for more than one year. The proportion rose to 46 per cent in the case of male recipients of unemployment assistance and to 56 per cent in the case of all male recipients aged 65 years and over. Payments to the unemployed decline over time, first through the exhaustion of payment related benefit and second through the exhaustion of entitlement to unemployment benefit. Transfers to the unemployed are regarded as short-term benefits and their rates of payment were increased by 20 per cent in recent budgets, compared to 25 per cent in the case of designated long-term benefits. The Council is concerned that a substantial minority of long-term recipients are dependent upon incomes which are clearly intended for subsistence in the short-term. In a previous report, the Council has recommended that the adequacy of benefits provided should receive particular attention.⁵⁰ The Council recommends that the question of providing more adequately for the needs of the long-term unemployed be given urgent consideration, while efforts should continue to be made to assist their return to gainful employment.

3.49 One of the aspects of the problem of unemployment which has received considerable attention internationally in recent years is the question of youth unemployment. The waste of human potential caused by unemployment is accentuated when the burden of unemployment falls on the young, particularly school-leavers. It is estimated that approximately 45,000 young people under 25, including school-leavers were unemployed at the end of 1980.⁵¹ The problem of youth unemployment was considered by a sub-committee of the Manpower Consultative Committee whose report was published in November 1980.⁵² The committee concluded that the level of youth unemployment was unacceptably high and that, because of the age structure of

⁵⁰NESC Report No. 61, paragraph 2.19.

⁵¹This estimate was given by the Minister for Labour in the course of a Dail Debate on youth unemployment, 3 February 1981.

⁵²Manpower Consultative Committee, *Report on Youth Employment*.

the population, the number of young people in the labour force would increase in the coming years. The Council endorses the committee's views that:

"the main cause of youth unemployment is the lack of job opportunities overall in the economy and not something related to the age of individuals. Thus a reduction in the level of youth unemployment will be achieved mainly through economic growth and the consequent increase in overall labour demand".⁵⁴

The Council endorses the recommendations made by the committee to enhance the job opportunities of young people, particularly of early school-leavers and handicapped young people.⁵⁵

3.50 The unemployed, young and old, living in the inner-city of Dublin face particular difficulties in securing employment. This reflects the shift in economic activity within the inner-city area away from traditional industry, the low level of educational attainment of many young people from deprived areas and the existence of discrimination in employment on the basis of home address. The dimensions of the problem were discussed in NESC Report No. 55.⁵⁶ The Council recommended in that report that an additional employment premium be paid to employers where jobs are provided to applicants from designated areas of high unemployment. The Council therefore welcomes the introduction of the Dublin Inner-City Employment Programme by the Department of Labour under which a premium is paid for 26 weeks to employers who recruit inner-city residents through the National Manpower Service. The Council welcomes the establishment of special units within that Service and the Industrial Development Authority (IDA) to concentrate on the particular problems of inner-city areas.⁵⁷

⁵⁴*Ibid*, page 4.

⁵⁵The Council notes that the question of youth unemployment in Ireland is being examined by a study team from the OECD as part of a cross-national programme.

⁵⁶NESC Report No. 55, *Urbanisation: Problems of Growth and Decay in Dublin*, (September, 1981).

⁵⁷The Council also welcomes the contribution made by grants from the Government's Inner-City Fund to alleviating some of the problems outlined in Report No. 55. This Fund is a flexible response to complex problems which transcend the functional boundaries of public agencies.

ADDENDUM TO CHAPTER 3

PRINCIPAL DEVELOPMENTS IN SOCIAL POLICY

(i) Health and Personal Social Services

The income limit for free consultant treatment in hospitals was raised from £7,000 to £8,500 per annum from June 1981. The Report of the Task Force on Child Care Services was published. A Review Body on Policies and Services for the Travelling People was established by the Ministers for Health and the Environment. (The Council welcomes the fact that the Review Group includes three members of the travelling community as an example of how recipients of services may be involved in their planning.) The Health (Mental Services) Bill, 1980 was passed by the Dail and provides a modern legislative framework for services for the mentally ill.

(ii) Housing

The number of houses completed in 1980 was the highest so far recorded. A new mortgage subsidy of £3,000 per annum was introduced, together with increase of limits in the SDA loan scheme and new arrangements to replace the low-rise mortgage scheme. Subsidies were paid to building societies to maintain the level of mortgage interest rates in 1980 and they were reintroduced in May 1981 to prevent a proposed increase in interest rates from coming into effect.

(iii) Education

A White Paper on Educational Development was published in 1981.

(iv) Social Welfare

Increases of 20 per cent were granted in payment rates for short-term benefits and 25 per cent in the case of long-term benefits in the 1981 Budget. Children's allowances were increased by approximately 30 per cent with effect from July 1981. A pay-related maternity benefit was introduced for women on maternity leave. The Social Welfare (Consolidation) Bill, 1980 was passed, bringing together the many legislative provisions in this area in one measure.

(vi) Law Reform

The Family Law (Protection of Spouses and Children) Bill, 1981 provides for greater flexibility in the granting of barring orders in cases of family violence and provides for more effective sanctions in the case of breaches of such orders. The Criminal Law (Rape) Bill, 1980 provides for changes in criminal procedure to lessen the burden of court proceedings on the victims of rape. The Courts Bill, 1980 provided for the transfer, *inter alia*, of a considerable amount of the family law jurisdiction exercised by the High Court to the Circuit and District Courts, thus enabling litigants to have their cases dealt with locally.

(vii) Other

Legal aid centres operated by the Legal Aid Board opened in August 1980. Income limits for legal aid were substantially revised in February 1981.⁵⁸ Subsidies in respect of basic food items were increased in May 1981 to offset increases in prices consequent on the outcome of the 1981 review of farm prices within the EEC.

⁵⁸The Council is disappointed to note that other means-test criteria, e.g. possession of a medical card, may not be substituted for detailed assessment of applicants' means in accordance with the legal aid scheme. The Council is concerned that multiple testing of means in different services be avoided if at all possible.

4.3 The balance of payments deficit on current account is equal to the difference between domestic expenditure on goods and services and National Disposable Income (NDI). Consequently, the deficit on current account is equal to the aggregate amount which Irish residents, companies and the State are spending in excess of their incomes.

4.4 The external deficit on current account has increased markedly relative to GNP in the past two years. Having averaged 3.4 per cent of GNP during the years 1971-78, it amounted to 10 per cent of GNP in 1979, 8 per cent in 1980, and is forecast to be almost 14 per cent of GNP in 1981.² Thus, for every pound received in income in Ireland in 1981, an estimated £1.14 is being spent. As is shown in Appendix 1, Ireland's deficit on current account relative to GDP³ has been by far the largest in the European Community since 1979, and is extremely high by the standards of other European countries (Tables A 1.2 and A 1.5).

4.5 The external deficit on current account must be financed either by a run-down of reserves, by capital transfers from abroad or by external borrowing (which may be public or private). Ireland's external deficit on current account in recent years has been financed mainly by borrowing abroad by the Exchequer and State-sponsored bodies. Foreign borrowing by the Exchequer and the State-sponsored bodies was approximately 90 per cent of the deficit on current account in 1979, and an estimated 120 per cent in 1980.

Causes of the Deficit on the External Current Account

4.6 The deterioration in Ireland's balance of payments position in recent years is partly attributable to the expansionary fiscal policies adapted in recent years, to increases in the price of oil and to the deterioration in the competitiveness of traded goods produced in Ireland.

4.7 Since 1978, the sharp increase in oil prices and the unfavourable external environment have adversely affected the rate of growth of national output and consequently the volume of resources earned by the community. Indeed between 1978 and 1981 national disposable income adjusted for changes in the terms of trade is expected to decline

²The current account deficit amounted to 9.4 per cent of GNP in 1974, the highest percentage in any year during the period 1965-78.

³For international comparative purposes GDP is used in the Appendix.

CHAPTER 4

STRATEGIC PROBLEMS FOR ECONOMIC AND SOCIAL DEVELOPMENT 1981-84

Introduction

4.1 The outlook for the international environment in 1981, within which the Irish economy must develop, is one of slow growth, rising unemployment and an easing of inflationary pressures, with some general improvement in growth expected in 1982. Against this international background, the Irish unemployment rate is forecast to rise to approximately 10.5 per cent in April 1982.¹ The Exchequer borrowing requirement and the public sector borrowing requirement as percentages of GDP are expected to be 16.5 per cent and 21.1 per cent respectively in 1981. The current account deficit on the balance of payments is likely to amount to 13.8 per cent of GNP. In the absence of an adequate policy response, this external current account deficit combined with a forecast inflation rate of 18 per cent must pose questions for the stability of the Irish pound in the EMS.

4.2 It is against this background that economic and social policies must be formed. This chapter identifies and presents an analysis of the strategic problems which must be addressed if economic and social objectives are to be achieved. The problems which have been identified are:

- (i) the balance of payments, and associated with this the budgetary situation
- (ii) inflation and the exchange rate
- (iii) employment and unemployment
- (iv) the implications of the demographic structure for social objectives
- (v) the need for redistribution of resources.

¹The definition of unemployment used here is that used in the Labour Force Surveys. The above estimate includes an estimated 15,000 first-time job seekers.

by some 5 per cent. However, actual living standards have been broadly maintained during this period, largely by means of increased public expenditure which has led to an increase in the public sector borrowing requirement from 15.7 per cent of GNP in 1978 to a forecast 21.1 per cent of GNP in 1981. This has been achieved at the cost of increased levels of official foreign borrowing to finance the associated deficit on current account.

The Deficit on the External Account and Official Foreign Indebtedness
 4.8 As noted in 4.5 above, the external current account deficit in the past two years has been financed almost entirely by large-scale foreign borrowing of the Exchequer and the State-sponsored bodies. The net external indebtedness of the State and State-sponsored bodies more than doubled between December 1978 and December 1980. The bulk of this debt must be financed through general taxation. The official external indebtedness per person employed in Ireland is shown in Diagram 1. Official debt per worker has increased from £305 in March 1974 to £1,250 in December 1978, and to £2,610 in December 1980. On the basis of the forecasts in Chapter 2, the official external debt per person employed will be in excess of £3,700 in December 1981.

4.9 Ireland's official indebtedness is relatively high, both in comparison with the other European Community member countries, and in comparison with countries at a similar level of economic development. Indeed, even prior to the recent rapid increase in the debt level, Ireland's foreign debt relative to GDP was higher than that of any other country at a similar income level, with the sole exception of Israel. Appendix 1 provides some international comparisons of official external debt levels and trends in such indebtedness.⁴

The Increasing Repayment Burden on Official External Debt

4.10 The primary cost of running persistent balance of payments deficits on current account is the repayment burden associated with increased levels of official indebtedness. The repayment burden with its implications for the public finances illustrates the nature of the balance of payments constraint on economic policy. The scale of external borrowing in recent years has resulted in a sharp increase in the level of domestic resources required to finance the higher official debt levels. In 1981, interest payments on official foreign debt will amount to £340 million.⁵ Capital repayments on the Exchequer debt will be £120 million,⁶

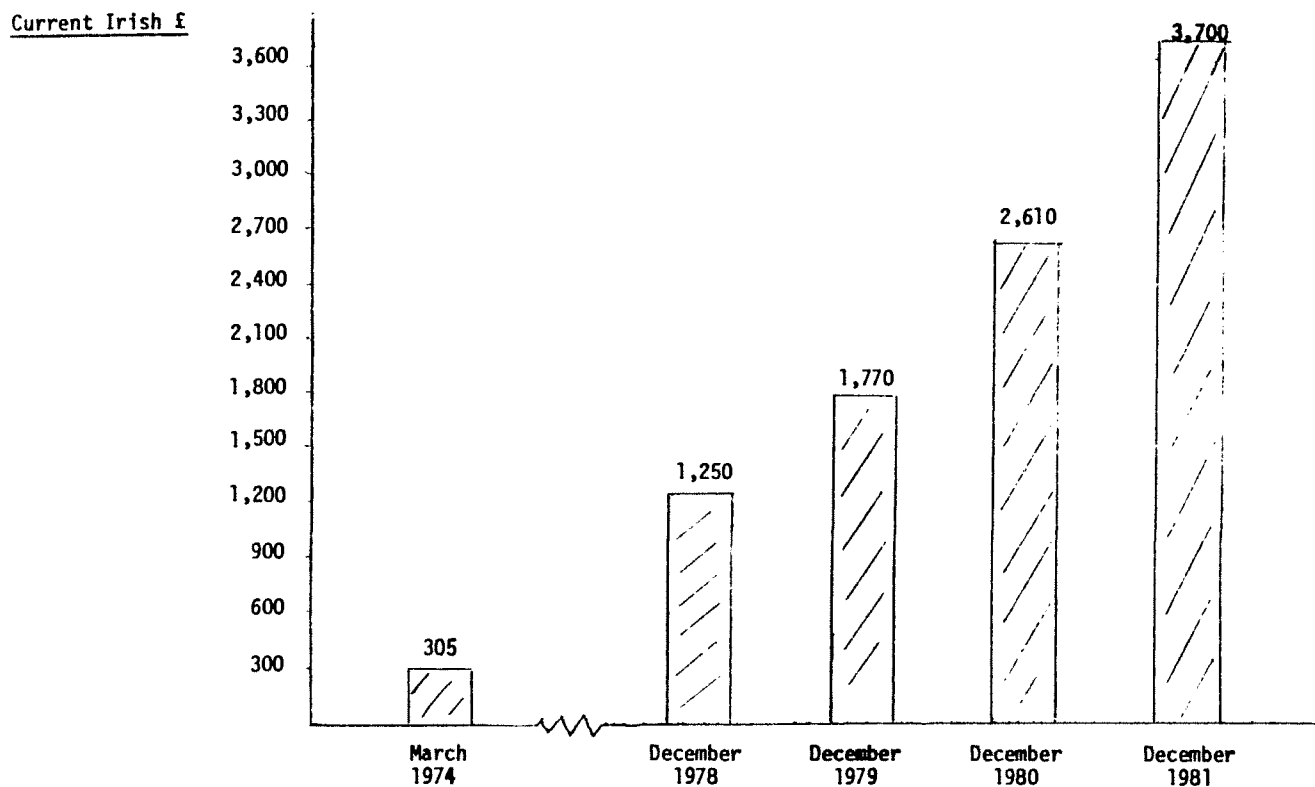
⁴The Department of Finance has expressed considerable reservations about the validity of these comparisons which are outlined in a footnote to Appendix 1.

⁵Minister for Finance, *Deil Debates*, 5 May 1981.

⁶Department of Finance. It is possible that these capital repayments may not represent a

Diagram 1

Official External Indebtedness per Employed Person



Note: 1981 figure is forecast
 Source: table A.1.3

1980 (see Appendix 2). Given that one-fifth of this total has been used to finance day-to-day expenditure, with a further share of funds being used to finance unremunerative investment, it follows that part of this foreign borrowing is leading to a reduction in future living standards.

Conclusions

4.14 Ireland's balance of payments deficit on current account has increased markedly in recent years with the forecast deficit on current account estimated to be almost 14 per cent of GNP in 1981—the largest deficit relative to GNP recorded since 1951. This deficit on current account has been largely financed by official external borrowing. The current level of official foreign borrowing is undesirable for the following reasons:

- (i) the rapidly rising burden of debt service places an increasing strain on the public finances and on the balance of payments deficit on current account. Foreign borrowing provides short-term relief from balance of payments and budgetary problems, but sustained borrowing only defers the need for underlying structural adjustment
- (ii) in a period when the rate of growth of output is relatively high, the required resource transfers might be accommodated without undue strain. However, given the current and medium term growth prospects for the world economy and for Ireland, and the extensive external borrowing, the resource transfers will involve increased rates of taxation. There is no alternative
- (iii) the larger the accumulated net external liabilities, with the resulting need to remunerate them, the more Ireland is vulnerable to trends in world trade. This is because a certain proportion of export earnings are already pre-empted to remunerate payments on external debt
- (iv) the larger the accumulated net external liabilities, the greater the vulnerability of Ireland to fluctuations in the availability and cost of finance in world capital markets. This vulnerability exists in two forms. First, there is the possibility of interest rate increases of the scale of 1980 and 1981, which affect both fresh borrowing and re-financing. Second, there is the vulnerability to changes in the terms under which foreign funds are lent arising from a deterioration in Ireland's credit rating. While Ireland's credit rating appears to be good at present, the rapidly rising debt to GNP ratio and debt to exports ratio may adversely affect this rating in the future
- (v) it is not wise to use foreign borrowing to fund current public expenditure since no additional income is generated to remun-

and repayments on the debt of the State-sponsored bodies will be of the order of £80 million. The total transfer of resources abroad in 1981 will therefore be £540 million, or approximately £460 per employed person. This is just under half the average amount expected to be collected from each worker in income tax in 1981. This resource flow implies a debt-service GDP ratio of 5.3 per cent and a debt-service exports ratio of 10 per cent. The corresponding figures for all middle-income developing countries in 1977 were 2.4 per cent and 9.2 per cent.⁷

4.11 Given that external borrowing by the Exchequer and the State-sponsored bodies is on present trends likely to continue to increase extremely rapidly (see 2.43 above), the interest burden will increase in real terms in future years. If the scale of official foreign borrowing that is likely in 1981 were to be repeated in 1982, interest payments on official debt in 1983 are likely to be of the order of £600 million, on the assumption of no change in the external value of the Irish pound. Scheduled repayments of Exchequer foreign debt outstanding at 30 June 1981 amount to over £300 million in 1983,⁸ with at least a further £120 million of repayments by State-sponsored bodies. Foreign loans arranged in the second half of 1981 and 1982 could further add to scheduled repayments in 1983. Consequently, with the continuation of existing policies, the total resource transfer required to service the official external debt would be some £1,000 million, or about £850 per worker. This is equivalent to over £16 per worker per week.

The Existing Usage of Foreign Borrowing

4.12 In a developing economy, access to foreign sources of funds enables the State to augment domestic savings with externally borrowed funds, thereby increasing the total funding available for investment purposes. If the return on public investment projects is sufficiently high (in terms of increased export receipts or reduced expenditure on imports) to service the debt, future incomes will be increased as a consequence of such investment. External borrowing that is used to finance day-to-day expenditure or to finance investment projects with a low or negative return will, however, leave future tax-payers worse off, in that they will have to meet the burden of debt repayment without an adequate increase in income to compensate for the debt burden.

4.13 Foreign borrowing, chiefly by the public sector, contributed about one-quarter of the total funds available for investment in 1979 and

⁷"true measure" of the annual repayment burden. In the absence of fixed annual amortisation, the repayments falling in particular years may be untypical.

⁸World Development Report, 1979

⁸Department of Finance.

(vi) erate repayments and interest payments on the borrowed funds the scale of foreign borrowing conceals the adjustment in expenditure and in incomes which is necessary to achieve a tolerable balance of payments deficit. This necessary adjustment requires that living standards be related to the resources available to the community. This adjustment of living standards and expectations to available resources, which is inescapable, can be brought about by planned measures which will ease the burden of adjustment and ensure its equitable distribution. If present policies are not altered, adjustment will be forced upon the community through the action of our creditors and/or a forced devaluation of the Irish pound within the EMS, both of which could involve undue hardship in their incidence on the community.⁹ In addition, devaluation would increase the burden of repayments and of interest payments on external debt, in domestic currency terms, as well as giving a renewed impetus to inflation.¹⁰

INFLATION AND THE EXCHANGE RATE

4.15 Prior to March 1979 the exchange rate policy pursued in Ireland was that of fixed parity with sterling. This exchange rate regime was one aspect of the close trading relationship between the Irish and UK economies, other aspects of which were the free movement of goods, capital and labour. The closeness of the relationship can be gauged from the fact that 51 per cent of Irish imports originated in the UK and that 43 per cent of Irish exports were destined for that market in 1980.

4.16 Exchange rate parity and the free movement of goods, capital and labour resulted in a close correspondence of Irish and UK inflation rate movements. (Table 54) Minor differences between the rates were a consequence of lags in the transmission of inflation, differences in price movements in the non-traded goods sectors, and differences in indirect tax changes and subsidies.

4.17 In March 1979, Ireland joined the European Monetary System. This involved a commitment by Ireland to the maintenance of the exchange rate within a fixed margin against the currencies of the EEC partners with the exception of the UK, the latter having decided against

⁹It is difficult to ensure equitable sharing of the burden of adjustment when this adjustment is forced upon the economy.

¹⁰The Council in Report No. 53 has already outlined why devaluation is inappropriate to Irish circumstances.

participation in the system. This effectively amounted to a decision to alter our exchange rate policy and the break in the link with sterling followed soon after our entry to the EMS as sterling appreciated *vis-à-vis* the EMS currencies.

4.18 This decision was viewed at the time as a commitment to a strong currency option.¹¹ It was argued that the link to a strong currency regime would lead to a convergence of the Irish inflation rate to the generally lower rates obtaining in the continental EEC countries.¹² It was recognised, however, that this convergence would not occur unless monetary and fiscal policies were designed to reduce both the current budget and external deficits and unless the growth of domestic incomes (adjusted for productivity movements) did not exceed those of the EMS countries.

4.19 It was envisaged that this convergence would take place directly through traded goods, price equalisation and indirectly through the adjustment of the current account of the balance of payments. Essentially, a rate of inflation in excess of that of our EMS partners would lead to a rise in the deficit in the external current account which in turn would lead to downward pressure on the exchange rate. It was envisaged that commitment to the preservation of the exchange rate within the EMS would provide the necessary discipline to manage the growth of demand in a way that would lead to convergence of the inflation rates and to the eventual reduction of the balance of payments deficit. In the absence of foreign borrowing, automatic balance of payments adjustment would come into play.

4.20 It was also envisaged that this balance of payments adjustment required to maintain the exchange rate would have adverse effects on output and employment. Loans with interest subsidies were obtained, designed to help finance the balance of payments deficit during a transitional adjustment period.¹³ In the event, the increase in the deficit has exceeded the "income transfers" and has been largely financed by external borrowing.

4.21 Following two years of EMS membership this convergence has not occurred. The Irish inflation rate in 1980 (18.2%) is still substan-

¹¹The European Monetary System (Prl. 7600). *Annual Report*, Central Bank, 1979. This view was based on an expected depreciation of sterling against the European currencies which proved incorrect in the light of later events.

¹²*Programme for National Development (1978-81)*. *Annual Report*, Central Bank, (1971).

¹³These resource transfers were also designed to help Ireland converge to European Community levels of development.

tially above the average EEC rate (12.2%), the divergence having actually widened between our entry to the EMS system and 1980. (Table 55) The current account deficit has also widened from 2.9 per cent of GDP in 1977 to 8.4 per cent of GDP in 1980. Why has convergence not occurred?

4.22 Effectively, the balance of payments constraint which was envisaged as providing the necessary discipline for the introduction of deflationary policies which would lower the rate of inflation has been rendered inoperative by virtue of the financing, in part, of the current account deficit in the short-run, through official external borrowing. This, combined with both the 13 per cent depreciation of the effective exchange rate¹⁴ between 1978 and the first quarter of 1981 (due mainly to the fall in the value of the Irish pound against sterling and the US dollar) and the failure to reduce the rate at which earnings (adjusted for productivity) increased, has resulted in the inflation rate remaining above the EEC average.

4.23 A number of other possible reasons, which are not exclusive of the above, can also be advanced for the non-convergence of inflation rates:

- (i) inertia in switching to non-UK supply sources
- (ii) a greater inflation rate in the non-traded goods sector than in other EMS countries
- (iii) the lags in the transmission of inflation may be longer than was envisaged at the time of EMS entry.

4.24 The balance of payments constraint, however, has been only temporarily removed. The financing of the current account deficit by means of Government borrowing is not sustainable in the long-run for reasons discussed in paragraphs 4.10 to 4.14. Even in the short-run, the scale of the current account deficit may produce strong pressures on the value of the Irish pound. It is relevant in this regard to examine the experience of Belgium, another small open economy participating in the EMS. The Belgian authorities have had to intervene heavily, on occasion, to defend the franc in the face of strong speculative pressures, after the widening of the deficit on current account to 5.6 per cent of GDP in 1980, and a forecast 6.6 per cent of GDP in 1981. The corresponding figures for the Irish economy are 8.9 per cent and 12.8 per cent, with price inflation in 1980 being 18.2 per cent, compared with 6.7 per cent in Belgium.

¹⁴The effective exchange rate is the average exchange rate against the currencies of Ireland's main trading partners, weighted by their relative importance in Irish trade.

THE EMPLOYMENT PROBLEM

4.25 Ireland's labour force¹⁵ is growing extremely rapidly, both by historical standards and in comparison with the European Community. During the period 1975-80, Ireland's labour force increased at an annual average rate of 1.6 per cent, compared with an average of 0.2 per cent for the European Community. While the rate of growth in the labour force may decline somewhat, given poor labour demand conditions,¹⁶ recent trends would indicate that the numbers at work or seeking work are still likely to increase by some 18-22 thousand per annum over the period 1980-84. Since mid-1980, the number of persons employed has declined and is unlikely to show any significant increase before mid-1982. As a consequence, unemployment in April 1982 is likely to be 35-40 thousand greater than the 74 thousand recorded in April 1980.¹⁷ Such is the scale of the unemployment problem, at least in the short-run, that if the April 1980 unemployment rate of 6 per cent is to be attained by April 1984, it is likely to require employment growth in excess of 3 per cent per annum between 1982 and 1984—an unprecedented rate of expansion.

The Cyclical Unemployment Problem

4.26 Cyclical unemployment is a consequence of fluctuations in the level of output around its long-term trend, arising from the operation of the business cycle. The traditional remedy for unemployment resulting from a cyclical decline in the level of economic activity is fiscal policy accompanied by an accommodating monetary policy.

4.27 However, expansionary fiscal policy is relatively ineffective in reducing the level of unemployment in a small open economy because a high proportion of the increased income is spent on imports, thus producing a significant deterioration in the current balance of payments. As a consequence the foreign borrowing cost of a fiscal policy-induced reduction in unemployment is relatively high. The causes of this high borrowing cost in Ireland are threefold. First, given the sensitivity of labour force participation rates and net migration rates to changes in the availability of jobs, a reduction in unemployment will require a significantly larger increase in employment. Second, an increase in

¹⁵The Labour Force is defined to be all those persons available and willing to work in gainful employment at prevailing income levels.

¹⁶This is because participation rates and migration flows are sensitive to labour demand.

¹⁷Unemployment figures used refer to the measure used in the Labour Force Surveys, and not to the Live Register. The numbers on the Live Register in April 1980 amounted to 92 thousand, compared with 74 thousand in the Labour Force Survey-based statistics. Neither estimate includes first time job seekers, an estimated 15 thousand.

employment will require a significantly larger than proportional increase in output. This arises from the fact that a substantial proportion of the output increase will be met through improved productivity rather than employment growth. Third, to achieve a given expansion in output, a relatively large balance of payments deterioration must be financed, due to the high import propensity of the Irish economy. This balance of payments deficit must be financed, all other things being equal, by an increase in the official external indebtedness of the State.¹⁸ As a result of the operation of these three factors, any reduction in the numbers unemployed resulting from fiscal policy actions is likely to entail a significant foreign borrowing cost per job. The corollary of this high external borrowing cost of reducing unemployment is that significant reductions in the external debt should not result in large-scale increases in unemployment.

4.28 While the high costs of reducing unemployment by fiscal policy measures in the Irish economy suggest that counter-cyclical expansionary policies should in any case be used sparingly, the high levels of Government foreign borrowing and the increasing burden of interest payments on outstanding debt leave no scope for their use at present.

4.29 The foreign borrowing cost of reducing unemployment also serves to highlight the balance of payments position as a fundamental constraint on economic policy-making in the Irish economy. Appropriate employment policies must be designed to avoid producing a deterioration in the balance of payments deficit on current account.

The Medium-Term Employment Problem

4.30 The Council, in a previous report, has highlighted the primary role of the internationally traded goods sector in generating sustainable output and employment growth. "In the growth process, the key sectors are agriculture and manufacturing industry—the sectors which produce physical goods".¹⁹ While some commodities produced in these sectors are not internationally traded—such as fresh milk, cement, packaging materials—agriculture and manufacturing can be broadly viewed as the sectors producing internationally traded goods, and jointly comprise the "exposed" sector. The achievement of sustained long-run employment growth requires the development of an environment conducive to the expansion of this exposed sector.

¹⁸The present discussion assumes unchanged interest rates and exchange rates, and the maintenance of the level of official reserves by the Central Bank.

¹⁹NESC Report No. 26, *Prelude to Planning*, (Dublin, 1976).

4.31 The Council is at present engaged in the preparation of a report which will examine the appropriateness of present policies for the development of the manufacturing sector. *The Review of Irish Industrial Policy* will include an appraisal of the various existing instruments of the Government's industrial policy and will have regard to such issues as:

- (i) the prospects of new growth industries
- (ii) the role of foreign industry
- (iii) the cost efficiency of the instruments of industrial policy.

Incomes and Employment

4.32 While appropriate medium-term policies are essential if sustained employment growth is to be achieved, such policies are unlikely to have a significant immediate effect on existing levels of unemployment. Given the constraints imposed by the balance of payments and budgetary positions, expansionary fiscal policy is not a realistic policy option in present circumstances. As import controls and devaluation are inappropriate to Ireland's specific circumstances,²⁰ moderation in the growth of incomes remains the only feasible option for reducing existing levels of unemployment. Income moderation also has beneficial effects on the balance of payments, through a reduction in import demand and through its effects on competitiveness.

4.33 The sheltered sector of the economy consists of those activities which are not in direct competition with foreign producers. The primary economic significance of the distinction between the sheltered and exposed sectors of the economy is that, in the former, cost increases can be passed on to the consumer in higher prices, whereas the presence of international competition in the exposed sector means that cost increases greater than those experienced in competing countries are less easily passed on to consumers. Sheltered sector activities include public sector services,²¹ professional services, the activities of financial institutions and the building and construction sector. The following paragraphs set out the effects of sheltered and exposed sector income increases on employment.

4.34 To analyse the effects of real income increases in the exposed sector, it is useful to view the exposed sector as being composed of three subsectors—agriculture, the indigenous manufacturing sector and the export-orientated foreign manufacturing sector.

²⁰The Council has previously pointed out that import controls and devaluation are inappropriate policies for the Irish economy. See NESC Report No. 53.

²¹In this case cost increases are passed on to the taxpayer in the form of higher taxes although foreign borrowing may postpone the date of payment.

employment will require a significantly larger than proportional increase in output. This arises from the fact that a substantial proportion of the output increase will be met through improved productivity rather than employment growth. Third, to achieve a given expansion in output, a relatively large balance of payments deterioration must be financed, due to the high import propensity of the Irish economy. This balance of payments deficit must be financed, all other things being equal, by an increase in the official external indebtedness of the State.¹⁸ As a result of the operation of these three factors, any reduction in the numbers unemployed resulting from fiscal policy actions is likely to entail a significant foreign borrowing cost per job. The corollary of this high external borrowing cost of reducing unemployment is that significant reductions in the external debt should not result in large-scale increases in unemployment.

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²¹In this case cost increases are passed on to the taxpayer in the form of higher taxes although foreign borrowing may postpone the date of payment.

4.35 The family farm basis of Irish agriculture ensures that the structure of incomes is markedly different from that of industry, with a mere 8 per cent of income arising from agricultural sector activities being in the form of employee remuneration.²² When demand for agriculture output falls or when output prices remain stable while input prices are rising, agricultural incomes rather than employment are affected. This is in contrast to industry, where employee income comprises the bulk of income arising, and where employment bears the bulk of the adjustment with unchanged real income per employed person. As a consequence, real income movements in agriculture have little direct effect on agricultural employment, although longer-term income disparities between agriculture and other sectors will affect the speed of employment decline in the agricultural sector. The efforts to maintain agricultural incomes at an equitable level has necessitated the intervention of both national and EEC authorities. The Council is at present preparing a report on *Farm Incomes* which will have regard to the current trends in farm incomes and will seek to identify what policies should be pursued in order that appropriate levels of farm incomes may be achieved and subsequently maintained.

4.36 In the indigenous manufacturing sector, real income increases of employees have two direct effects on employment. First, rising employee costs relative to the cost of capital goods encourages firms to substitute capital for labour in the production process, thereby reducing employment even at unchanged levels of output. This effect, however, is likely to be of limited significance in the short-term. Second, given that Irish firms compete at externally determined price levels, real income increases for employees which are not matched by productivity increases will result in a price-cost squeeze with consequent adverse effects on output and employment.

4.37 In the foreign-owned manufacturing sector, employee income movements may have additional effects on employment in that it may affect the firm's international location choice. Wage movements are likely to have their greatest effect on firms examining the attractiveness of Ireland as a location base rather than on firms already located here, although such firms' reinvestment plans would obviously be affected.²³

4.38 Incomes in the sheltered sector can be divided into three categories—employee incomes, self-employed persons incomes and non-labour incomes, such as dividends from sheltered sector firms and rents.

²²Average for 1973-78. *National Income and Expenditure*, 1978.

²³See IDA *Annual Report*, (1980).

Significant real income increases for any of these groups will lead to an increased demand for imports and pressure on the balance of payments.

4.39 Income increases in sheltered sector activities also affect employment in the exposed sector, through their effects on the competitiveness of this sector. First, rising output prices of many sheltered sector activities, such as electricity, communications, building and construction, automatically result in increased costs for exposed sector activities, with a consequent reduction in profitability. Second, to the extent to which sheltered sector employees are successful in maintaining their real post-tax earnings, the operation of the comparability principle between employee earnings in exposed and sheltered sector activities can result in a similar compensation being sought by employees in the exposed sector resulting in declining competitiveness of the exposed sector. Third, increases in profitability in sheltered sector activities can lead to a diversion of capital out of the exposed sector, into safer and more profitable sheltered sector activities.

4.40 In conclusion, real income movements have significant effects on the level of employment. Such real income movements operate both through the effects on the competitiveness of the exposed sector, and also through effects on the demand for imports. Moderation in the growth of real incomes will consequently provide a significant stimulus to employment growth, even in the short-term.

DEMOGRAPHIC STRUCTURE AND SOCIAL OBJECTIVES

4.41 The implications of the demographic structure for social policy derives from the demand for social services which it implies. The Irish demographic structure is unique by European standards. (Table 56) In 1978 each member of the active population (working or seeking work) in Ireland supported an average of 1.9 dependants, compared to an average of 1.4 in the EEC as a whole. This is mainly due to the proportion of children in the Irish population, almost one-third in 1979. While the dependency ratio (those aged 0-14 years plus those aged 65 and over, as a proportion of those aged 15-64) is projected to decline over the period to 1991,²⁴ the burden of dependency at that time will still be significantly in excess of that in other European countries.

4.42 Many social services are particularly concerned with the needs

²⁴For a discussion of these projections see NESR Report No. 62, *Population and Labour Force Projections by County and Region, 1979-91* (forthcoming).

of children and the elderly e.g. education, health services. Similarly, income maintenance services are dominated by the support of the elderly and of children, whether as dependants of social welfare recipients or through the payment of children's allowances. The demand for these services is likely to increase in line with increased numbers in these age groups. There is, therefore, little prospect that the volume of public social services and hence the level of social expenditure can be reduced without seriously affecting the most vulnerable groups in the community. Indeed, in view of the relatively heavy burden of dependency it would be surprising if the proportion of national output devoted to social expenditure in Ireland were not higher than in European countries.

4.43 A further implication of the demographic structure is the projected increase in the labour force in the coming decade. Over the period 1966-79 the labour force increased by 99 thousand as a result of population growth, offset to some extent by a decline in activity rates in certain age groups. It is likely that the labour force will continue to grow over the coming decade, resulting in the slight reduction in the burden of dependency noted above. The provision of secure, well-paid employment for the increased numbers seeking work will constitute one of the principal challenges in the area of economic and social policy.

REDISTRIBUTION

4.44 The reduction in the inequalities of income and wealth, together with the elimination of inequalities of opportunity, constitute some of the principal aims of social policy. The extent of inequality is substantial; in 1973 the top 9 per cent of households (in terms of gross income) had over 24 per cent of disposable income while the lowest 20 per cent received 5 per cent of disposable income.²⁵ The principal means of reducing the inequalities generated by the market are the tax and transfer systems. The aim of public policy in this regard should be to ensure that they are progressive, i.e. transfer resources from higher to low income groups. The evidence for 1973, the latest year for which data are available, suggests that taxes and transfers do have a broadly redistributive effect.²⁶

4.45 Certain expenditure programmes do, however, have a clearly

²⁵B. Nolan, "The Personal Distribution of Income in the Republic of Ireland", *Journal of the Statistical and Social Inquiry Society of Ireland*, (Dublin, 1977/78).

²⁶CSO, *The Distributive Effects of State Taxes and Transfers on Households in 1973*, (1980).

regressive effect, i.e. they benefit higher income groups more than proportionately. Examples of such programmes include expenditure on higher education and on subsidies to owner-occupiers. The tax system may also raise revenue in a regressive fashion. Thus indirect taxation is frequently regressive (but this is not necessarily the case). Within the income tax system, the system of allowances allied to a nominally progressive tax structure results in the value of allowances to taxpayers increasing with their income. Furthermore, certain allowances and deductions in the tax system are more likely to be availed of by higher income groups, e.g. allowances for interest paid, medical insurance. These allowances have a regressive effect and they also result in a considerable reduction in the average rates of tax paid under a nominally progressive tax structure. Additional revenue could be raised in a more progressive fashion if the amount of income excluded from tax were reduced by, for example, restricting their value to the tax-payer to the standard rate equivalent, rather than the marginal rate.

4.46 Almost every action of public agencies has implications for the distribution of resources between different groups in the community. The need for policies to address the economic problems now facing the economy is addressed elsewhere in the report. The successful implementation of these policies will require that they operate and are seen to operate with due regard to their distributive implications.

CHAPTER 5

AIMS AND RECOMMENDATIONS¹

Introduction

5.1 Chapter 4 contained an analysis of the problems facing the Irish economy. These problems are broadly similar to those which were discussed in the most recent Council report on the economy (Report No. 53), except that they have now become more urgent:

- (i) the unemployment rate, including first-time job seekers, of 7.1 per cent in 1980 is forecast to increase to 9.3 per cent in 1981 and to 10.5 per cent in 1982²
- (ii) the balance of payments deficit on current account was 8 per cent of GNP in 1980 and is expected to be almost 14 per cent in 1981
- (iii) the current budget deficit as a percentage of GNP was 6.6 per cent in 1980 and is expected to be 7.9 per cent in 1981. The Exchequer borrowing requirement and the public sector borrowing requirement were 14.6 per cent and 18.9 per cent of GNP respectively in 1980 and are expected to reach 16.5 per cent and 21.1 per cent in 1981. Foreign borrowing as a percentage of GNP increased from 6.4 per cent in 1979 to 7.0 per cent in 1980
- (iv) the Irish inflation rate in 1980 was 18.2 per cent compared to an EEC average of 12.2 per cent. The Irish rate of inflation is expected to be slightly higher in 1981
- (v) unit labour costs in Ireland increased by 5.3 per cent relative to the average of the main industrialised countries in 1979 and by a further 7 per cent in 1980.

5.2 The Council's principal recommendations in Report No. 53 were the elimination of the current budget deficit over the three

¹The Secretary of the Department of Finance did not participate in the discussions in so far as they involved specific budgetary policy recommendations.

²The definition of unemployment here corresponds to the definition used in the labour Force Surveys.

year period 1981-83 and that real incomes should reflect the growth in domestic output adjusted for the terms of trade. Depending on the progress made in reducing the current budget deficit the Council considered that productive capital expenditure might be allowed to increase in real terms on a selective basis. Finally, the Council recommended that increases in public sector pay should be related to the Government's capacity to pay.

5.3 These recommendations are still relevant twelve months later but are more urgently in need of full implementation. Unless there is a commitment to policies which tackle the problems specified in Chapter 4 and paragraph 5.1 as a matter of urgency, the achievement of real and sustainable growth in employment and incomes and the maintenance and development of existing levels of public social expenditure will not be possible. The following paragraphs outline the Council's recommendations on policies.

FISCAL POLICY

Current Public Expenditure

5.4 In report No. 53 the Council recommended that the 1980 Budget forecast for the current deficit should not be exceeded and that the 1981 Budget strategy should involve substantial progress in the reduction of the current budget deficit. The 1980 Budget contained a forecast of 4.2 per cent of GNP for the current budget deficit. The out-turn for that year was 6.6 per cent of GNP. The excess of the actual over the forecast figure was almost entirely due to the excess of public expenditure over the original forecasts. The January 1981 Budget estimated a current budget deficit of 5.2 per cent for 1981. The revised estimate given in the *Financial Statement*, July 1981 indicates a final current budget deficit for the year of £787 million, approximately 7.9 per cent of GNP.

5.5 Appendix 3 contains estimates of budgetary trends, in the absence of policy changes, for the period 1981-84. The following (neutral) budgetary stance is assumed:

- no change in the volume of Government current or capital expenditure
- indexation of specific rates of indirect taxation
- indexation of income tax allowances.

Other assumptions include a 10 per cent rate of price inflation per

annum and an increase of 1.8 per cent in the rate of price increase of Government provided goods and services relative to other goods and services. Against this budgetary stance it is estimated that with a growth rate of 2.5 per cent for domestic output, the current budget deficit would rise to £1,405 million in 1984. At that time service of public debt would absorb 99 per cent of receipts from income tax and would amount to a "tax" of 21 per cent on total non-agricultural domestic income. Relative to GNP,³ the current budget deficit would be 10.0 per cent in 1984, higher than the proportion of 7.9 per cent in 1981.

5.6 With the existing tax system a higher rate of growth will not lead to the automatic elimination of the current budget deficit. It is estimated that if there were a sustained rate of growth of 4.5 per cent per annum, the current budget deficit would be equal to £986 million or to 6.7 per cent of GNP in 1984. This is with the 'neutral' Budget assumption, which involves no change in the volume of Government current or capital expenditure over the three years. Moreover, this outcome is likely to under-estimate the deficit in 1984, for two reasons. First, past experience suggests that with a higher growth rate, input prices tend to be bid up. Second, a rate of growth of 4.5 per cent per annum would be likely to lead to increased demand for public goods and services.

5.7 Paragraphs 5.5 and 5.6 illustrated the extent of the budgetary imbalance likely to result if present policies are unchanged. The potential for restoring balance through the curtailment of public expenditure is limited. In 1980 expenditure on debt service, income maintenance and public sector pay amounted to 73 per cent of current Government expenditure.⁴ In addition, a proportion of non-pay public current expenditure is devoted to the provision of social services which are designed to cater for the needs of dependent groups e.g. children, the elderly. In view of our demographic structure it is unlikely that significant reductions could be effected in this area of expenditure.

5.8 In 1980 the Council recommended the elimination of the current budget deficit over the three year period 1981 to 1983 inclusive.⁵ The deterioration in the state of public finances since then means that the elimination of the deficit is now more difficult. The elimination of the deficit over a very short period such as 12 months would result in a

³In this section the current budget deficit is forecast as a percentage of GDP rather than GNP due to the greater difficulty in forecasting the latter.

⁴The corresponding figure for 1979 was 70.4 per cent.

⁵NECS Report No. 53, *op. cit.*

severe deflationary shock to the economy while an attempt to eliminate it over a relatively long period such as seven years could prove impossible since, for example, the increasing burden of interest payments could outweigh attempts to raise revenue or reduce expenditure. The Council, therefore, recommends that a target of three years be set for the elimination of the deficit.

5.9 The successful elimination of the current budget deficit will reduce the repayment burden on future tax-payers referred to in 4.11 and 4.12 and lead to an improvement in the balance of payments position through a reduction in imports. The openness of the economy will ensure that much of the deflationary impact of the elimination of the deficit will result in a reduced demand for imports rather than a severe decline in domestic employment.⁶ The elimination of the deficit combined with an incomes policy as outlined below would minimise short term adverse effects on employment while providing a basis for long-term employment growth.

5.10 It is clear that a balanced current budget is not a realistic possibility without a reduction in the volume of public expenditure and/or faster growth in revenue. Any attempt at blanket reductions in public spending without regard to the redistributive and employment consequences, and in particular to the likely impact on the most vulnerable groups in the community, would be undesirable. This implies that the identification of areas of public expenditure where reductions might be made will require careful evaluation of the efficiency, effectiveness and equity of expenditure programmes. Similarly, the methods by which increased revenue might be sought have serious implications for social equity. The extent of the current deficit has been aggravated by the elimination or reduction in recent years of substantial sources of tax revenue. Domestic rates, for example, would have raised £63.3 million in 1978 which is equivalent to £100 million at 1981 prices. Similarly, motor taxation on cars up to and including 16 horse-power was abolished in 1977 at a full year cost of £27 million, equivalent to £40 million at 1981 prices.⁷ The revenue foregone from these services alone, without taking account of possible changes in the real value of their yield, was equivalent to over one quarter of the current budget deficit in 1980.

⁶This is the corollary of the argument outlined in paragraph 4.27 that expansionary fiscal policy is relatively ineffective in reducing the level of unemployment in an open economy.

⁷The increases in motor registration fees in the January 1981 Budget restored less than one-quarter of this revenue. In the July 1981 Budget the Minister for Finance stated that motor tax would be reintroduced with effect from 1 September 1981 at the 1977 rates. The estimated full year revenue would be £27.5 million.

5.11 The level of income tax revenue is largely dependent on the system of tax allowances and deductions. The value of these allowances and deductions (which removed over one-third of gross income from tax in 1977/78) flows disproportionately to higher income groups because of the structure of the tax system. The cost of these allowances and deductions in terms of revenue foregone in 1980/81 was 116 per cent of the 1980 current budget deficit. These allowances and deductions are available to all tax-payers and their elimination would not be feasible under the present tax system. However, if the tax reliefs and deductions available to individuals (other than personal allowances)⁸ had been valued at the standard rate, rather than the tax-payer's marginal rate, in 1980 approximately £25 million would have been raised in additional revenue. Such reductions in exclusions from income tax would result in a more progressive tax system as well as contributing to the reduction of the current budget deficit. The question of widening the tax base, in particular through greater use of capital taxation (which contributed only 0.7 per cent of total revenue in 1980) should be considered from the point of view of promoting a more equitable distribution of resources as well as its contribution to the elimination of the current budget deficit.

5.12 The reduction in public expenditure which may be necessary to complement the raising of additional revenue should not take place on a pro-rata or across-the-board basis. Rather, the allocation of resources should have regard to the effectiveness of expenditure programmes including their distributive consequences. The Council has already outlined its views on areas of priority within the field of social expenditure.⁹ The recent increased levels of subsidy for owner-occupiers are a further example of expenditure which does not meet the criteria of social priority. In view of the labour intensity of most public services, a reduction in average real pay levels in the public sector would have a substantial impact on public expenditure without, of itself, affecting the availability of services.

Capital Expenditure

5.13 During the period 1976-80 fixed capital formation both public and private amounted to an average of 30 per cent of GDP. While recognising the long pay-back and social nature of many investments,

⁸The reliefs concerned are: dependant relative allowance, PAYE allowance, age allowance, housekeeper allowance, relief of loan interest, relief of superannuation contributions, life assurance relief, medical insurance relief, children's allowance (social welfare) relief, relief of bank deposit interest.

⁹NEESC, Report No. 61.

the level of investment has not yielded a commensurate increase in output.¹⁰

5.14 There is a valid case for the financing of a deficit in the public capital programme by foreign borrowing when the resulting investments provide a return to the State, directly or indirectly, sufficient to meet interest charges and capital repayments. The Council is concerned that new public investments should meet this criterion. In order to reach a balanced judgement on this matter the Council, while recognising a case may be made for certain expenditures on productive infrastructure, recommends that the returns from all public capital expenditure should be rigorously evaluated. In January 1981 the Government introduced the *Investment Plan 1981* which provided for total public investment during the year of £1,700 million. On present information it is not possible for the Council to evaluate the productivity of the planned investment.

Monetary Policy

5.15 A fiscal policy aimed at eliminating the current budget deficit and reducing the external current deficit must be complemented by an appropriate monetary policy. A large part of the exchequer borrowing requirement is financed by monetary means and the public sector accounts for a predominant part of domestic credit expansion.¹¹ While the Central Bank has considered that the rate of growth of domestic credit is excessive, it has nevertheless taken account of the needs of the private sector in determining its credit policy. Whether the reduction in the Exchequer borrowing requirement which would result from the elimination of the current budget deficit would enable the credit available to the private sector to be increased would depend on a number of factors—for example, the impact on the external deficit and the monetary financing of the reduced borrowing requirement.

Incomes Policy

5.16 In recent years the rate of growth in the community's expenditure has exceeded the rate of growth in the community's resources. During 1977-80 domestic expenditure rose by 11.1 per cent while gross national disposable income adjusted for the terms of trade rose by 5.4 per cent.¹² In 1979 and 1980 the adverse movements in Ireland's

¹⁰The gross incremental capital output ratio provides a crude indication of the productivity of investment. This ratio deteriorated from approximately five over the period 1968-75 to eight over the period 1977-80, suggesting a decline in the productivity of investment.

¹¹In 1980 the Government share of domestic credit expansion was 55 per cent.

¹²The balance of payments deficit on current account is equal to the difference between domestic expenditure and gross national disposable income.

terms of trade implied a transfer of resources to her trading partners.¹³ The divergence between income and expenditure has been financed by foreign borrowing. Recourse to borrowing for this reason is not sustainable.

5.17 The future growth of the economy is dependent on the success of the exposed sector in home and export markets. This success is primarily determined by prevailing income levels, by productivity and also, of course, by such factors as management practices and marketing. The index of unit labour costs (Table 9) indicates the extent to which Ireland has been losing cost competitiveness relative to the main industrialised countries. Over the period 1978-80 inclusive, Ireland's competitiveness deteriorated by approximately 14 per cent. The consequences of this decline in competitiveness have been offset to some extent by the greater decline in competitiveness in the UK, due mainly to the marked appreciation of sterling in 1980. This compensating factor, however, is unlikely to persist over the medium-term. The loss of competitiveness in home and export markets has led and will continue to lead to a loss in employment.

5.18 The cost competitiveness of the exposed sector¹⁴ will depend not only on pay and other direct cost increases, but also on the rate of price increase of raw materials and services which it purchases from the sheltered sector. It is essential that pay and other cost increases higher than in competing countries do not become the general norm. Pay and income increases in the sheltered sector should be related to the increases which the exposed sector can bear.

5.19 Given the serious deterioration in competitiveness which has occurred in recent years and its adverse effects on output and employment, the Council considers that adoption of an incomes pause—as defined in paragraph 5.20 below—is an essential element in aiding the restoration of economic competitiveness in the short-term.¹⁵ Calculations on this specific point made available to the Council¹⁶ indicate that on current trends, an incomes pause of eighteen months duration would be required to offset the decline in competitiveness which has occurred since Ireland's entry to the EMS. In this context,

¹³In 1979 and 1980 respectively, adverse movements in the terms of trade reduced the volume of resources available to the community by 1.9 and 3.7 percentage points.

¹⁴The exposed sector as broadly defined in Chapter 4 includes agriculture and manufacturing industry.

¹⁵Over the medium term more efficient management practices and improved marketing are also essential elements for ensuring a return to previous competitive levels.

¹⁶Received from the Central Bank.

the Council recommends the adoption of a pay pause for eighteen months or, at the very least, for the longest sustainable period leading to eighteen months following the expiry of the second National Understanding.^{17, 18, 19} Following the restoration of previous competitive levels the Council recommends that income increases should not exceed what the exposed sector will bear.

5.20 The Council wishes to emphasise that if the economy is to derive maximum benefit from such a policy, all incomes and not just employee incomes must be subject to the pause. This would include employee incomes, income from self-employment and non-labour income such as dividends and rents. In a situation where there is an income pause it will be necessary to ensure strict implementation of the price control criteria of the National Prices Commission²⁰ in order that price increases intended to compensate for increases in income are not granted. Because of its special circumstances, including in particular the fixing of prices at EEC level, the Council is not including the agricultural sector in this recommendation for an incomes pause. The Council intends, however, to comment, in detail on this issue in its forthcoming report of farm incomes.

5.21 A pause in nominal income growth, followed by a growth in incomes in line with what the exposed sectors can bear, would not only improve competitiveness with the consequent beneficial effects on employment, it would also lower inflationary pressures in the economy, have significant beneficial effects on the external current account and would significantly ease the burden of adjustment on employment which the elimination of the current budget deficit would entail.

¹⁷Mr T O Cearbhaill suggests that, before any decision is taken on this matter, all interests who would be affected by an incomes pause should be consulted and account taken of their views in framing, and operating, whatever decision is taken.

¹⁸Professor Hannan does not accept that sufficient evidence has been presented to support the recommendation of a general incomes pause for a specific period nor that the full economic and social consequences of such a pause have been adequately evaluated.

¹⁹A note of dissent to this proposal was provided by the ICTU representatives on the council on 17 September 1981. This note appears in full as Appendix 5 to this report.

²⁰The coverage of the National Prices Commission is not total. In so far as manufacturing industry is concerned there is broad coverage by virtue of the dominant firms being controlled. Limited control is exercised over service industries, importers and wholesalers. The NPC does not have a function in regard to dividend or rent control.

Table 3

Employment Performance by sector, 1975-81 (a) (b)

	1975	1977	1979	1980 (c)	1981 ^f (d)
Agriculture	238	228	223	220	216
Industry	337	336	365	372	362
Of which: Manufacturing	224	226	239	243	n.a.
Building and construction	89	87	101	103	n.a.
Services	498	519	557	571	576
Total employed	1 073	1 083	1 145	1 163	1 154
Unemployed	73	89	74	74	104
Unemployed (including those seeking first job)	88	104	89	89	119
Total labour force (excluding those seeking first time job)	1 146	1 172	1 219	1 237	1 258
Unemployment rate	6.4%	7.6%	6.1%	6.0%	8.3%
Unemployment rate (including first job seekers) (e)	7.6%	8.8%	7.2%	7.1%	9.3%

Notes: (a) Figures refer to mid-April

(b) These employment data are markedly different from employment data presented in NESR Report No. 53 since substantial statistical revisions have been carried out by the CSO, based upon the 1979 Census of Population

(c) 1980 figures are provisional

(d) 1981 figures are NESR forecasts

(e) Assumption of 15 000 seeking first job

Source: Central Statistics Office, ERO, Summer 1981.

Table 4

Agricultural Output Trends 1977-80

% Increase	1978	1979	1980
Gross output-value	17	5	-1
Net output-value	15	-2	1
Income from self-employment	12	-12	-9
Output price index	13	6	-2.7
Input price index	4	13	14.5
Volume of gross output	6	-1	0
Volume of net output	2	-10	7

Source: CSO.

Table 1

Expenditure on GNP 1976-80

% change per annum, compounded annually

	1977	1978	1979	1980
Private consumption	4.0	8.8	3.6	-1.2
Public consumption	2.3	4.3	3.5	4.0
Gross fixed capital formation	6.3	17.3	15.6	-7.9
Exports of goods and services	13.5	12.7	6.7	7.0
Imports of goods and services	13.0	15.2	14.7	-4.0
Gross Domestic Product	5.8	6.3	1.9	2.1
Gross National Product	5.4	6.3	1.8	1.4
GNP, allowing for changes in terms of trade	4.7	7.3	0.6	-2.4
Growth of GDP:				
EEC	2.4	3.2	3.5	1.2
OECD-Europe	2.3	3.0	3.3	1.4
OECD	3.8	3.9	3.3 (a)	1.3 (a)

Note: (a) GNP.

Sources: *Economic Review and Outlook*, Summer (1981); OECD, *Economic Outlook*, December (1980), July (1981).

Table 2

Sectoral Performance, 1976-80

A. Output

	Sectoral share (GDP) 1976 (factor cost)	Growth rate		
		1977	1978	1979 ^e
Agriculture	%	9.9	1.9	-5
Industry	17.1	8.0	10.4	8
Services	34.7	3.1	4.8	2
	48.2			
				1980 ^f
				%
				7.5
				-2.5
				0.5

B. Employment

	Sectoral share Mid-April 1977	Growth rate		
		1977-78 ^e	1978-79 ^e	1979-80
Agriculture	%	-0.9	-1.3	-1.3
Industry	21.1	4.2	4.3	1.9
Services	31.0	2.9	4.3	2.5
	47.9			
				1980-81 ^f
				%
				-1.8
				-2.7
				+0.9

Notes: ^e Estimate^f forecast

Sources: Output: NIE, 1978.

ESRI, QEC, January (1980) September (1980).

Employment Table 3, ERO, Summer (1981).

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Private consumption	4.0	8.8	3.6	-1.2
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	48.2				0.5

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Agriculture	%	-0.9	-1.3	-1.3	%
Industry	21.1	4.2	4.3	1.9	-1.8
Services	31.0	2.9	4.3	2.5	-2.7
	47.9				+0.9

Notes: ^e Estimate
^f forecast

Sources: Output:

NIE, 1978.
ESRI, OEC, January (1980) September (1980).
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Table 4

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Input price index	4	13	14.5
Volume of gross output	6	-1	0
Volume of net output	2	-10	7

Source: CSO.

Table 2
Trend in cattle numbers and output 1974-80

	Total cows ('000)	Beef cows ('000)	Cattle output ('000)	Creamery cows ('000)	Milk deliveries (m gallon)	Delivery cow (gallon)
1974	2 208	732	1 809	1 246	571	458
1975	2 102	611	1 859	1 237	625	505
1976	2 047	547	1 617	1 274	675	530
1977	2 092	537	1 769	1 333	735	551
1978	2 096	502	1 813	1 378	842	611
1979	2 108	484	1 737	1 410	864	613
1980	2 035	448	1 644	1 377	837	608

Source: CSO and AFT.

Table 6
Manufacturing industry: output and employment, 1976-80

	1977	1978	1979	1980
Volume of output (% change)	8.7	7.8	5.8	-2.0
Employment (% change)	3.1	3.0	4.1	-1.1
Net increase in employment	6 100	6 100	8 500	-2 400

Note: All changes are changes in annual averages.

Sources: Monthly Industrial Enquiry, December (1980), CSO; Employment, Earnings, Hours Worked, December (1980).

Table 7

Manufacturing industry: employment by sector

	% change (a)				
	1977	1978	1979	1980	1976-80 Average annual growth rates (compounded annually)
Food	0.7	2.4	2.4	-3.4	0.5
Drink/tobacco	2.0	2.9	-	1.9	1.7
Textiles	1.7	0.5	3.8	-6.8	-0.3
Clothing/footwear	1.5	-	1.0	-8.3	-1.5
Paper/printing/wood products	-2.1	4.3	-1.2	-3.8	-0.7
Non-metallic mineral products	6.1	7.2	1.3	-1.3	3.3
Chemicals	2.0	8.7	8.0	-4.1	3.5
Metals, engineering	8.1	3.0	8.9	2.3	5.5
Miscellaneous	9.6	5.5	5.2	1.0	5.3

Note: (a) All growth rates are September-September.

Source: CSO, Employment, Earnings, Hours Worked, March, June, September, (1980).

Table 3
Disposable personal income, 1976-80

	Annual % change			
	1977	1978	1979	1980
Current Prices				
Personal income	18.7	17.4	15.5	n.a.
Disposable personal income	18.2	18.3	16.2	n.a.
Average earnings, transportable				
goods industry	17.1	14.3	15.3	18
Family farm income	38.9	12.4	-11.6	-9.5
Profits, professional earnings, rents etc.	24.4	21.1	19.0	2.5
Constant Prices^a				
Personal income	5.4	10.1	2.0	n.a.
Personal disposable income	5.0	10.3	3.7	n.a.
Average earnings, transportable				
goods industries	4.0	6.5	2.9	-0.2
Family farm income	23.4	5.3	-21.5	-23.5
Profits, professional earnings, rents etc.	10.5	12.9	6.1	-13.5

Note: ^aDeflator used is private consumption expenditure deflator.

Sources: NIE, (1978); ERO, Summer (1981); ESRI, QEC January (1980).

Table 9

Relative unit labour costs in dollar terms ^a , EEC countries 1977-80				
	1978	1979	1980	
Belgium	0.9	-4.2	-5.4	
Denmark	-0.3	3.4	-10.2	
Germany	5.9	1.5	-3.4	
France	-5.7	2.3	1.9	
Italy	0.1	2.0	0.2	
Netherlands	0.9	-0.8	-5.9	
Ireland	1.1	5.3	7.0	
UK	8.8	15.9	32.0	

Note: ^aUnit labour costs in dollars by reference to the weighted average for the main industrialised countries

Source: EEC *European Economy* No. 8, March (1981).

Table 10

Ireland's foreign trade performance 1976-80

	1977	1978	1979	1980
(1) Growth in volume: Irish exports of goods and services (%)	13.5	12.7	6.7	7.0
(2) Growth in volume: all world commodity trade (%)	4.0	5.0	6.0	1.0
(3) Ireland's terms of trade (Base, 1968 = 100)	103.1	104.6	100.6	94.4
(4) Ireland's export share of total world exports (%)	0.432	0.484	0.481	0.459
(5) Ireland's export share of developed countries manufactured goods exports (%)	0.397	0.426	0.473	0.499
(6) Ireland's export share of EEC manufactured exports (%)	0.737	0.785	0.852	0.915

Sources: (a) Table 1

(b) UNMBS; *United Nations Monthly Bulletin of Statistics* (UNMBS), May (1981), NIESR

(c) Central Bank

(d) UNMBS, May (1980)

(e), (f) UNMBS, March (1981); *Trade Statistics of Ireland*, December (1978), December (1979), December (1980); Exchange Rate Data; *International Financial Statistics Yearbook*, (1980), for data up to 1979, *Central Bank Quarterly Bulletin* (QB), December (1980) for 1980 data.

Table 12

Inflation, international comparisons, 1976-80

% Change in consumer prices

	1977	1978	1979	1980	Dec 79-Dec 80
Ireland	13.6	7.6	13.2	18.2	18.2 (a)
UK	15.8	8.3	13.4	18.0	15.1
EEC	9.9	7.0	8.9	12.2	11.8
OECD-Europe	11.3	9.4	10.6	14.3	13.7

Note: (a) November-November growth rate

Source: OECD, *Economic Outlook*, December (1980); OECD, *Main Economic Indicators*, February, March (1981).

Table 13

Ireland's exchange rate 1977-80

Foreign currency for Irish £: annual period average

	1977	1978	1979	1980	31 December 1980
Pound Sterling	1.00	1.00	0.96	0.89	0.796
U.S. Dollar	1.75	1.92	2.05	2.06	1.898
German Mark	4.05	3.85	3.75	3.73	3.717
French Franc	8.57	8.65	8.71	8.68	8.569

Sources: QB, 1 and 4 (1980); OECD, *Main Economic Indicators*, February (1981).

Table 11

The balance of payments, 1977-80

£ million

	1977	1978	1979	1980
Balance of trade (1)	-618	-735	-1347	-1290
Net invisible exports (2) (a)	463	535	620	590
Balance of current account (3)=(1)+(2)	-155	-200	-727	-700
Net Government borrowing (4)	199	342	318	n.a.
Private capital inflow (5) (b)	201	-191	132	n.a.
Implied capital inflow (6)=(4)+(5)	400	251	450	1071
Change in official reserves (7)=(3)+(6)	245	51	-277	371

Notes: (a) Includes net transfers with the rest of the world.

(b) Derived residually.

Sources: CSO; ERO, Summer (1981); Central Bank, QB, 1 (1981).

Table 14

Change in Government expenditure, 1976-80

	1977	1978	1979	1980
<i>% Changes: nominal values</i>				
Transfer payments	18.0	18.4	20.1	23.6
Expenditure on goods and services	16.7	24.7	22.8	29.5
Government current expenditure	17.3	21.2	21.4	26.5
Government capital expenditure	-1.0	30.1	25.1	31.9
Total Government expenditure	13.8	22.8	22.1	27.5
<i>% Changes: real values (1975 prices)</i>				
Transfer payments	4.7	10.4	7.1	4.6
Expenditure on goods and services	2.8	12.8	-0.8	4.3
Government current expenditure	3.8	11.5	3.3	4.5
Government capital expenditure	-15.3	18.1	9.6	13.3
Total Government expenditure	0.1	12.6	4.4	6.1

Notes: (i) The present table is derived from the National Accounts classification of the budget expenditures.

(ii) Government capital expenditure also includes a transfer element.

Deflators: (a) Transfer payments—private consumption deflator

(b) Expenditure on goods and services—public consumption expenditure deflator

(c) Capital expenditure—fixed capital formation deflator

Sources: Annual Budgets; Table 24.

Table 15

Government expenditure in relation to GNP, 1976-80

(%)

	1977	1978	1979	1980
<i>Ratio to GNP: market prices</i>				
Government current expenditure	38.4	39.9	42.0	45.9
(a) transfers	20.5	20.8	21.6	23.1
(b) expenditure on goods and services	17.9	19.1	20.3	22.8
Capital expenditure	18.0	8.9	9.7	11.1
Total expenditure	46.5	48.8	51.7	56.9
<i>Ratio to GNP: constant prices</i>				
Government current expenditure	39.1	41.0	41.6	43.1
(a) transfers	20.7	21.5	22.6	23.3
(b) expenditure on goods and services	18.4	19.5	19.0	19.7
Capital expenditures	7.8	8.7	9.3	10.4
Total expenditures	46.9	49.7	50.9	53.5

Note: Items need not sum exactly due to rounding errors

Sources: Table 1; Table 14.

Table 16

Service sector employment: 1977-81

'000s

	1977	1978	1979	1980	1981
Civil service (c)	51.7	52.5	55.4	57.0	58.4
Local authorities administration (d)	15.2	16.3	16.3	16.5	16.2
Other public sector (e)	152.8	157.5	166.5	171.1	175.0 ^f
Total public sector services (a)	219.7	226.3	238.2	244.6	249.6 ^f
Total service sector (b)	519.0	n.a.	557.0	571.0	576.0 ^f
Private sector	299.3	n.a.	318.8	326.4	326.4 ^f

Notes: (a) January each year

(b) Mid-April each year, 1980 is provisional; 1981 forecast.

(c) includes small number of industrial Civil Service (211 on 1 January 1981) scale-point staff, mainly sub-postmasters (3 435, January 1981)

(d) Number of local authorities employees attributable to "Public Administration and Defence"

(e) Garda Síochána, Defence Force, Teachers, Health Boards, Other Health Sector Universities, Other Education State-Sponsored Bodies.

^fNESC estimates.

Sources: Department of Public Service; CSO; Table 3.

Table 17

Exchequer pay costs, 1975-80

	1975	1976	1977	1978	1979	1980
Exchequer pay costs (IR£ million)	516.6	628.9	719.2	862.3	1 079.1	1 452.9
Real Exchequer pay costs (1975 IR£ million)	516.6	529.8	537.9	601.5	671.2	764.2
Exchequer-funded employment (000's)	172.9	177.2	182.0	189.8	198.1	202.3
Real Exchequer pay costs per employee (1975=100)	100.0	100.1	98.9	106.1	113.4	126.4

Notes: (a) Deflator used is private consumption expenditure deflator

(b) Employment data used is an average for January of the year in question and January of the following year

Sources: Department of Finance; Department of the Public Service; Table 24.

Table 18

Estimated real earnings: selected groupings 1975-80

1975 = 100

	1975	1976	1977	1978	1979	1980
GNP, volume terms	100	101.4	106.9	113.6	115.7	117.3
GNP per employed person (a), (b)	100	n.a.	105.4	n.a.	107.9	107.7
Average real earnings, transportable goods industries						
Family farm real income	100	100.7	105.0	112.0	115.0	114.9
Real pay costs per employee	100	94.4	116.5	122.7	96.3	72.2
Public Service, Definition 1	100	100.1	98.9	106.1	113.4	126.4
Public Service, Definition 2	100	95.6	92.8	97.0	104.6	113.2

Notes: Public Service, Definition 1: includes all those employees whose salaries are paid direct out of Exchequer pay bill

Public Service, Definition 2: includes, in addition to these workers, all local authority employees, but excludes employees of the voluntary hospitals and the Post Office, secondary school teachers and university employees

(a) The recent revision of the employment data will entail revisions of GNP data; consequently the resulting GNP per employed person estimates for 1977, 1979 and 1980 are likely to be under-estimates

(b) Employment data is for April of each year.

Sources: Tables 1, 3, 8, 17, 24, Department of Finance; CSO.

Table 19

Ratio of tax revenue to GNP, 1977-81

(%)

	1977	1978	1979	1980
Total tax revenue:				
Ratio to GNP	32.0	31.6	32.3	35.7
Taxes on income and wealth				
Ratio to GNP	16.5	16.2	17.2	19.5
Taxes on income and wealth - Share of total tax revenue	51.6	51.4	53.3	54.6

Sources: Annual Budgets, Table 1.

Table 20

Current budget deficit, Exchequer borrowing and public sector borrowing 1977-80

	1977	1978	1979	1980
Current Deficit				
(1) £m	201	397	522	547
(2) As % of GNP	3.8	6.4	7.31	6.6
Exchequer Borrowing				
(1) £m	545	810	1 009	1 217
(2) As % of GNP	10.2	13.0	14.0	14.6
Government Foreign Borrowing (a)				
(1) £m	121	283	459	583
(2) As % of GNP	2.3	4.5	6.4	7.0
Public Sector Borrowing (b)				
(1) £m	703	981	1 258	1 578
(2) As % of GNP	13.2	15.7	17.5	18.9

Notes: (a) Includes sales of securities to non-residents

(b) Equals Exchequer borrowing plus non-Exchequer capital resources less internal resources of State bodies and local authorities.

Sources: Annual Budgets; Table 1; Table 21.

Table 21

Financing of Exchequer borrowing requirement, 1977-80

	1977	1978	1979	1980
Net sales of securities to:				
(1) domestic non-bank public	204	227	256	319
(2) non-residents	50	260	-50	17
(3) commercial banks	154	67	104	243
Small savings	102	65	27	52
Borrowing from Central Bank	-	-	100	-
Government net foreign borrowing	71	23	509	566
Changes in liquidity of Department funds	-51	165	21	-
Miscellaneous borrowing	15	3	42	20
Total Exchequer borrowing	545	810	1 009	1 217
Current budget deficit (£m)	201	397	522	547
as share of Exchequer borrowing (%)	37	49	52	45
Foreign financing (a) of Exchequer borrowing (£m)	121	283	459	583
as share of Exchequer borrowing (%)	22	35	45	48

Notes: Classification of funds in 1977 and 1978 follows that of OECD Economic Survey; "Ireland", January 1981

(a) Foreign financing = Government net foreign borrowing plus net sales of securities to non-residents.

Sources: Annual Budgets, QB 1 and 4 (1980); Department of Finance.

Table 22

Official foreign indebtedness of state, 1977-80

Millions of Irish pounds

	1977	1978	1979	1980
External Government debt (a)	1 039	1 064	1 542	2 200
External debt of State-sponsored bodies	334	327	485	835 ^a
(1) Total official debt	1 373	1 391	2 027	3 035
(2) Official external reserves	1 201	1 252	975	1 346
Debt reserves ratio = (1) ÷ (2)	1.14	1.11	2.08	2.25

Notes: External debt of the State-sponsored bodies does not include foreign currency borrowing from Irish resident banks. If such borrowings were included, the total official debt in millions of Irish pounds in the four years 1977-80 would have been £1,449, £1,494, £2,122 and £3,210, respectively.
^a Estimated from increase in net external liabilities of State-sponsored bodies, QB, 1 (1981).

(a) Excludes securities held by non-residents.

Sources: Central Bank, QB, 4 (1980), 1 (1981), Department of Finance.

Table 23

Domestic Credit Expansion (DCE), 1977-80

	Government borrowing (1)	Sales of securities to domestic non-bank public (2)	Small savings (3)	Bank-lending to non-Government sector (4)	DCE 1+4 -(2+3) = (5)
1977	545	204	102	552	791
1978	810	227	65	836	1 354
1979	1 009	256	27	875	1 801
1980	1 217	319	52	700	1 546

Government share of Domestic Credit Expansion

	1977	1978	1979	1980
%		%	%	%
30		38	45	55

Sources: Table 21; Central Bank, QB, 1 (1981).

Table 24

Implicit price deflators, 1975-80

	1975	1976	1977	1978	1979	1980
Private consumption expenditure	100	118.7	133.7	143.4	160.8	190.1
Public current expenditure	100	116.0	131.7	145.4	180.3	221.4
Gross domestic fixed capital formation	100	118.7	138.7	152.9	174.3	203.3
GNP	100	120.1	134.9	148.5	168.1	191.9

	1976	1977	1978	1979	1980
% Change in price indices:					
Private consumption expenditure	18.7	12.6	7.3	12.1	18.3
Public current expenditure	16.0	13.5	10.4	24.0	22.8
Gross domestic fixed capital formation	18.7	16.8	10.2	14.0	16.7

Sources: 1975-78, NIE 78; 1979-80, ERO, Summer (1981).

Table 25

Economic performance: European Community
1973-76, 1979-81

% Change

	1973	1974	1975	1976	1979	1980 ^a	1981 ^f
GDP, volume	5.9	1.7	-1.4	5.0	3.4	1.3	-0.6
Fixed capital formation volume	4.5	-3.3	-4.8	3.3	3.8	2.1	-1.0(a)
Consumer prices	8.2	12.7	12.5	10.3	8.9	12.1	10.4

Notes: (a) 1981 capital formation forecast is from *European Economy*, November (1980), likely to have been revised downward since then.
^e estimate
^f forecast

Sources: *European Economy*, November (1980) for 73-76 data and 79-81 investment data; *European Economy*, Supplement A, March (1981).

Comparison of the two 'Oil' recessions: initial conditions

	1973 %	1979 %
(1) Initial balance of payments current account deficit, as share of GNP	3.1	10.1
(2) Official foreign indebtedness (a) As share of reserves (%) (b) As share of GNP (%)	March 1974 76 12	December 1979 208 28
(3) Current budget deficit As share of GNP	Average 1971/73 0.23	Average 1977-79 5.8
(4) Exchequer borrowing requirement As share of GNP	7.3	12.4

Sources: (1) NIE 1978; ERO, July (1980)

(2) Central Bank QB, 4 (1980), 1 (1976)

(3) Annual Budgets; NESC Report No. 53, Table 18

(4) Annual Budgets; NESC Report No. 53, Table 18.

Table 27

Output of cattle and calves (1977-81)

	1977	1978	1979	1980	1981
Live exports	453	550	327	473	—
Deermeat production (a)	1 146	1 148	1 138	1 350	—
Total exports	1 599	1 698	1 465	1 823	1 320
Imports	-142	-120	-158	-78	-90
Slaughtering for domestic consumption	311	324	322	318	320
Output (excl. inventory)	1 768	1 903	1 629	2 063	1 550
Inventory change	1	-90	108	-419	+50
Output (incl. inventory)	1 769	1 813	1 737	1 644	1 600

Note: (a) including intervention stocks

Sources: CSO and NESC estimates.

Table 28
Agriculture: aggregate output and incomes and price and volume indices

	1975	1976	1977	1978	1979	1980	1981	Change 1981/80 %
Gross output (£m)	859	1 023	1 366	1 593	1 677	1 666	1 810	8.6
Net output (£m)	662	761	1 024	1 178	1 151	1 163	1 265	8.8
Income from self-employment (£m)	477	536	744	835	734	672	766	14.0
Output price index	100	126	154	174	184	179	204	13.7
Input price index	100	116	141	147	165	189	213	13.0
Index volume of gross output	100	96	105	112	111	111	106	-4.4
Index volume of net output	100	90	99	101	91	98	93	-5.3

Sources: CSO and NESC estimates.

Table 29

Output forecast 1981

	1980	% Change 1981 over 1980		1981
		Volume %	Price %	
Private consumption expenditure				
Public expenditure on current goods and services	5 315	-0.75	20.0	6 330
Gross domestic fixed capital formation	1 851	0.0	21.0	2 240
Change in physical stocks	2 503	8.0	18.0	3 190
Exports of goods and services	-114	1.25	15.0	20
	4 669			5 435
Final demand	14 224	2.5	18.0	17 215
Imports of goods and services	5 800	3.25	18.5	7 080
GDP	8 424	2.0	18.0	10 135
Net factor income	-95			-200
GNP	8 329	0.75	18.25	9 935

Balance of Payments, 1981

Exports of goods and services	5,435
Imports of goods and services	-7,080
Net factor income from abroad	-200
Net international transfers	470
Deficit on Current Account	1,375

Source: NESO

Table 30

1981 monetary forecasts

(A) Supply and demand for funds

Demand		Supply	
Exchequer borrowing requirement	1 640	Increase in non-deposit liabilities of the banking system	250
Non-Government lending of banking system	850	Increase in M3	820
		Net external finance	990
		Sales of securities, to non-bank public	430
	2 490		2 490

(B) Financing of the Exchequer borrowing requirement

Exchequer borrowing requirement	1 640	Sales of securities to the non-bank public	430
		Net borrowing from banking system	350
		Net foreign borrowing	860
	1 640		1 640

(C) Composition of net external finance

Net external finance	990	Exchequer foreign borrowing	860
		Flow fall in reserves	0
		Inflows through Commercial Banks	230
		Revaluation effects	-100
	990		990

(D) Financing of the balance of payments deficit

Current account deficit	1 375	Exchequer external borrowing	860
		State-sponsored bodies borrowing	300
		Capital transfers, other flows	-15
		Inflows through Commercial Banks	230
		Flow change in reserves	0
	1 375		1 375

Table 31

House completions 1975-80

	(1) Total completions	(2) Of which local authority completions	(3) (2) as % of (1)	Waiting list for LA dwellings approved and unapproved
1975	26 892	8 794	32.7	
1976	24 000	7 263	30.3	
1977	24 548	6 333	25.8	33 500
1978	25 444	6 073	23.9	35 000
1979	26 544	6 214	23.4	32 500
1980	27 785	6 008	21.6	n.a.

Source: Quarterly Bulletin of Housing Statistics, March (1981).

Table 32

Public capital expenditure on housing, 1976-81

	Public capital expenditure Current prices	Constant (1975) prices		Proportion for local authority housing (%)
		Total	% increase on previous year	
1976	£m 105.4	£m 90.4	-21.5	62
1977	99.9	73.1	-19.1	71
1978 (p)	128.4	85.3	+16.7	59
1979 (p)	169.0	97.1	+13.8	53
1980 (p)	216.3	103.3	+6.4	53
1981 (e)	274.9	110.3	+6.8	51

Notes: (p) provisional
(e) estimate

Source: Quarterly Bulletin of Housing Statistics, March (1981).

Public capital

Main constituents of public capital expenditure on housing, 1976-81

Private Housing		Grants from department of the environment (b)		Local authority housing		Other (c)		Total	
Year	£m	£m	%	£m	%	£m	%	£m	%
1976	30.0	28.5	6.5	65.3	62.0	3.6	3.3	105.4	100
1977	22.7	22.7	4.3	70.7	70.8	2.3	2.2	99.9	100
1978	35.4	27.6	11.3	75.8	59.0	2.8	2.2	128.4	100
1979	53.0	24.6	14.6	89.6	53.0	1.8	1.3	169.0	100
1980	72.8	27.0	12.5	113.6	52.5	2.9	1.3	216.3	100
1981	101.6	28.5	11.8	141.0	51.3	3.8	1.5	242.4	100

Notes: (a) these figures include expenditure on the low-rise mortgage scheme. Supplementary grants were terminated in 1978 apart from transitional cases

(b) these figures include payments of £1,000 grants for first-time owner occupiers of new houses and house improvement grants terminated in 1980 apart from transitional cases

(c) principally expenditure by the IDA; SFADCo; Department of Defence; Roin na Gaeltachta and the National Building Agency.

Source: Quarterly Bulletin of Housing Statistics, March (1981).

Table 34

Subsidies and rents as % of total current receipts for local authority dwellings, 1975-79

	1975		1976		1977		1978		1979	
	£m	%	£m	%	£m	%	£m	%	£m	%
Rent subsidies	27.0	68.4	30.5	62.8	33.7	64.4	46.2	69.0	61.3	71.9
Rent receipts	8.7	22.0	9.9	20.4	12.3	23.5	13.9	20.7	16.4	19.2

Source: Quarterly Bulletin of Housing Statistics, March (1981).

Table 36

Average deposit required on new houses being purchased with building society loans, 1976-80

	Gross deposit (a) (1)	State grant (b)		Deposit net of state grant	
		Money value (2)	as percentage of gross deposit (3)	Current prices (4)	Net deposit as % of gross average industrial earnings per annum (5)
1976	1 211	325	26.8	886	27.7
1977	1 457	663	45.6	794	20.7
1978	1 859	1 000	53.8	859	19.4
1979	2 343	1 000	42.6	1 343	27.3
1980	2 799	1 000	35.7	1 799	30.8

Notes: (a) assumes a 90 per cent loan on an average priced house

(b) the £1,000 grant, introduced in July 1977, was restricted to first-time buyers of new houses. The 1977 figure in column (2) is an average for the twelve months.

Source: Quarterly Bulletin of Housing Statistics, March (1981).

Table 35

Approved applications according to family size and category, 30 September 1980

Category	Family size							
	1	2	3	4	5	6	7	Total
Unit	1 235	1 421	1 431	806	370	169	182	5 614
Overcrowded	506	2 604	4 578	2 387	942	434	433	11 884
Unfit and overcrowded	78	271	716	733	435	260	451	2 944
Medical/compassionate	687	600	474	230	103	34	36	2 164
Other	1 218	1 312	1 075	602	225	103	66	4 601
Totals	3 724	6 208	8 274	4 758	2 075	1 000	1 168	27 207*
%	67							100
	33							

Notes: *Of the 27 708 approved applications detailed analysis is only available for 27 207. Applications from families consisting of three persons or less account for 67 per cent of all approved applications and applications from families consisting of four persons or more constitute 33 per cent.

Source: Department of the Environment.

Table 37

Initial monthly repayments to building societies for mortgages on average-priced new houses, 1976-81

	(1) Total loan (a)	(2) Monthly repayment	(3) Average monthly male industrial earnings (b)	(4) Repayment as % of earnings at (3)
1976	9 690	97	267	36.3
1977	11 656	117	320	36.6
1978	14 874	140	369	37.9
1979	18 746	238	410	58.0
1980	22 390	268	456	58.8
1981 (first quarter)	24 150	290	n.a.	n.a.

Notes:

(a) assumed an 80 per cent mortgage on an average priced house payable over 20 years

(b) figures for industrial earnings refer to total transportable goods industries and relate to the position at June of each year.

Sources: Column (1), Quarterly Bulletin of Housing Statistics, March (1981).
Column (3), CSO.

Table 38

Net monthly repayment to building societies: 1st three years of mortgage

Marginal tax rate	Gross monthly repayments (a)	Net monthly repayments			
		Year 1		Year 2	
		£	£	£	£
%					
35	283	59 (b)	184 (c)	76	142
45	283	31 (b)	156 (c)	52	114
55	283	2 (b)	127 (c)	27	85
60	283	— (b)	113 (c)	15	71

Notes: (a) the gross repayments are based on current repayments on a mortgage of 80 per cent of the price of a new house approved for a loan in the last quarter of 1980
 (b) assumes that the mortgage subsidy of £1,500 is offset against repayments
 (c) assumes that the subsidy of £1,500 has been used to finance the deposit.

Source: *Quarterly Bulletin of Housing Statistics*.

Table 39

Capital expenditure on education, 1976-81

	Public capital programme		% increase on previous year
	At current prices	At constant (1975) prices	
	£m	£m	
1976	27.98	24.08	—
1977	37.36	27.33	+13.9
1978	46.92	31.17	+14.0
1979	53.11	30.50	-2.1
1980	60.80	28.82	-5.5
1981	80.07	31.63	+9.8

Source: *Public Capital Programme*, various years.

Table 40

Current public expenditure on education, 1976-81

	Current prices £m	Constant (1975) prices £m	% increase on previous year
1976	234.8	202.6	—
1977	272.0	207.3	+2.3
1978	308.6	204.1	-1.5
1979	393.0	215.2	+5.4
1980	486.0 (p)	216.0	+0.4
1981	601.0 (e)	224.3	+3.8

Notes: p = provisional
 e = estimate

Source: *Book of Estimates*, various years.

Table 41

Additional teachers and buildings required in education, 1981-91 (e)

Level	Additional teachers required (b)	Additional buildings (c) sq metres
First	1 800	600 000
Second	2 150	550 000
Third	1 000 (d)	250 000

Notes: (a) these are the totals required over the decade 1981-91 to meet projected demand by 1991

(b) exclusive of replacement for retirements etc

(c) inclusive of replacement of obsolete and substandard accommodation

(d) estimate provided by the Department of Education.

Source: *White Paper on Educational Development*.

Table 42

Average annual cost of providing additional teachers and buildings, 1981-91 at 1981 prices

Level	Additional teachers £m	Additional buildings
First	10.1	22.5
Second	11.6	30.0
Third	8.8	17.5
Total	30.5	70.0

Source: Department of Education.

Table 43

Health services capital expenditure 1976-81

	Public capital programme current prices (£m)	Constant (1975) prices (£m)	% Change on previous year
1976	11.2	9.7	—
1977	16.0	11.7	+20.6
1978	21.5	14.3	+22.2
1979	27.5	15.8	+10.5
1980	35.0	16.6	+5.1
1981	47.0	18.8	+13.3

Source: *Book of Estimates*.

Table 44

Current public expenditure on health services, 1976-81

	Current prices (£m)	Pay as % of total	Constant (1975) prices (£m)	% Change
1976	275	61.5	237	-2.2
1977	328	62.0	250	+5.4
1978	400	64.0	265	+6.0
1979	540	64.8	296	+11.7
1980	666	65.5	296	0.0
1981	733 ^e	66.4	274	-7.4

Note: e = estimate

Source: Book of Estimates; Department of Health.

Table 45

A. Current public expenditure on health by programme 1976-81

	£m				
	1976	1977	1978	1979	1980
Community protection	6.1	7.6	9.4	12.3	13.9
Community health	45.1	46.5	57.6	70.0	82.7
Community welfare	16.9	27.6	30.0	36.2	43.5
Total community	68.1	81.7	97.0	118.5	140.1
Psychiatric programme	39.1	46.5	55.6	69.0	85.5
Programme for the handicapped	22.2	30.1	37.1	47.8	61.0
General hospital programme	139.5	173.0	213.2	306.4	378.5
General support programme	21.7	24.3	26.1	30.8	32.0
Gross expenditure	290.6	355.6	429.0	572.5	697.0
Income	16.0	27.1	29.0	32.5	31.0
Net expenditure	274.6	328.5	400.0	540.0	666.0

B. Percentage shares of current public expenditure on health

	1976	1977	1978	1979	1980	1981(e)
	%	%	%	%	%	%
Community protection	2.1	2.1	2.2	2.1	2.0	1.8
Community health	15.5	13.1	13.4	12.2	11.9	12.6
Community welfare	5.8	7.8	7.0	6.3	6.2	6.3
Total community	23.4	23.0	22.6	20.6	20.1	20.7
Psychiatric programme	13.5	13.1	13.0	12.1	12.3	12.8
Programme for the handicapped	7.6	8.5	8.6	8.3	8.8	8.1
General hospital programme	48.0	48.7	49.7	53.5	54.3	53.3
General support programme	7.5	6.7	6.1	5.5	4.5	4.6

Note: e = estimate.

Source: Department of Health.

Table 46

Current public expenditure on social welfare, 1976-80

Year	Current prices £m	Constant 1975 prices		
		Deflator (1)		Deflator (2)
		£m	% change	£m
1976	447	386	—	379
1977	511	389	+0.7	381
1978	592	385	-1.1	404
1979	690	377	-2.1	423
1980	889	408	+8.2	461

Notes: Deflator (1) is that for net current expenditure by public authorities
Deflator (2) is based upon changes in the Consumer Price Index.

Source: Department of Social Welfare.

Table 47

Unemployment benefit and assistance

A. Average weekly number of recipients — unemployment benefit and assistance 1976-80

	1976	1977	1978	1979	1980
Unemployment benefit	59 873	54 866	47 959	42 000	47 264
Unemployment assistance (a)	47 399	49 936	48 743	46 197	43 204
Pay-related benefit (b)	22 363	19 304	17 056	13 900	21 553
Total no. of recipients (c)	107 372	104 802	96 702	88 197	90 468

B. Expenditure on payments to the unemployed, 1976-80

	£m				
	1976	1977	1978	1979	1980
Unemployment benefit	43.3	44.5	44.5	43.2	70.5
Unemployment assistance (a)	31.9	38.5	43.4	47.9	88.2
Pay-related benefit (b)	7.9	7.6	7.7	8.7	17.7
Total	83.1	90.6	95.6	99.8	148.0
As % of social welfare expenditure	18.6	17.7	16.1	14.5	16.6

Notes: (a) figures exclude smallholders

(b) payments with unemployment benefit only

(c) recipients of related benefit are a sub-total of recipients of unemployment benefit.

Source: Department of Social Welfare.

Table 48

Social Welfare expenditure and income, 1980

Source	%	Expenditure	%
Exchequer	55.5	Administration	4.8
Social insurance contributions	44.3	Social insurance (a)	54.9
Other	0.2	Social assistance (b)	40.3

Notes: (a) Social Insurance schemes include (1980 expenditure): old age (contributory) pensions (£103m); disability benefit (£99m); invalidity pension (£24m); maternity allowance (£4m); maternity grant (£0.4m); retirement pension (£50m); widows' and orphans' (£86m); deserted wife's benefit (£5m); death grant (£0.5m); pay-related benefit (£37m); treatment benefit (£6m)

(b) Social Assistance schemes include (1980 expenditure): old age and blind (non-contributory) pensions (£140m); children's allowances (£75m); unemployment assistance (£82m); widows' and orphans' pension (£14m); free travel scheme (£11m); free electricity allowance (£9m); supplementary welfare allowance (£5m); social assistance allowances including deserted wives', unmarried mothers', single women's and prisoners' wives' (£15m).

Source: *Book of Estimates*; Department of Social Welfare.

Table 49
Exchequer expenditure on the social services, 1976-81

Expenditure (current prices) (a) £000		As % of Government current expenditure									
1976	1977	1978	1979	1980 provisional	1981 estimate	1976	1977	1978	1979	1980	1981
34.8	72.0	8.6	393.0	86.0	601.0	14.1	13.9	12.9	13.4	13.3	13.9
254.0	309.9	375.1	624.2 (b)	598.7 (b)	657.3	15.3	15.9	15.6	16.3	16.3	15.2
29.7	30.7	45.0	53.5	64.5	68.4	1.8	1.6	1.9	1.8	1.8	1.6
198.5	234.6	265.7	311.3	395.8	n.a.	—	—	—	—	—	—
251.9	279.5	319.1	378.7	493.2	604.2	15.1	14.3	13.3	12.9	13.4	13.9
770.4	892.1	1 047.8	1 349.4	1 642.4	1 930.9	46.3	45.7	43.6	46.5	44.8	44.6
Capital expenditure	28.0	37.4	46.9	60.8	80.1	5.1	5.6	5.9	5.3	4.8	4.6
Education	11.2	16.0	21.5	27.5	47.0	2.0	2.4	2.7	2.7	2.8	2.7
Health	107.1	100.7	135.5	159.3	242.4	19.5	15.2	6.9	15.8	15.9	13.9
Housing	146.3	154.1	203.9	239.9	297.2	26.6	23.2	25.5	23.8	23.5	21.2
Total	146.3	154.1	203.9	239.9	297.2	369.5	26.6	23.2	25.5	23.8	23.5

Notes: (a) the Exchequer figures are taken from outturn figures contained in the *Book of Estimates*. In the case of health expenditure, these differ from the net non-capital expenditure figures given in Chapter 3 because the total expenditure of health agencies is not recouped in full in the year of account

(b) pay awards of £35 million backdated to 1979 and paid in 1980, have been allocated to the 1979 outturn for health and total Government expenditure

(c) this is the amount voted as a subsidy for houses provided by housing authorities for letting, and other minor subsidies, including mortgage interest subsidies

(d) the expenditure shown for the social insurance fund is only that portion derived from contributions from employers and employees and other, non-exchequer, income. The exchequer figures include grants to the social insurance fund.

Sources: *Book of Estimates*, various years; *Report of the Department of Social Welfare 1976-78*.

Table 50

Estimated cost in revenue foregone of the principal income tax allowances and reliefs

Allowance/relief	1979/80 £m	1980/81 £m	% increase
Personal allowances:			
Married	273	246	-9.9
Single and widowed	164	157	-4.3
One parent families	1	3	+200.0
Child allowance	47	43	-8.5
Dependant relative allowance	5	5	0
PAYE allowance	-	98	-
Age allowance	2	1	-50.0
Housekeeper allowance	1	1	0
Relief of loan interest paid in full	30	36	+20.0
Relief on superannuation contributions paid by employees	10	14	+40.0
Life assurance relief	8	9	+12.5
Medical insurance relief	4 (a)	5 (b)	+25.0
Children's allowance (Social Welfare) relief	9	15	+66.7
Relief of bank deposit interest—first £70	3	3.5	+16.7
Capital allowances—machinery etc.	43 (a)	63 (b)	+46.5
Stock relief	10	11 (c)	+10.0
Export sales relief	53 (a)	85.6 (b)	+48.3

Notes: (a) these figures relate to the tax year 1978/79

(b) these figures relate to the tax year 1979/80

(c) this figure relates to the calendar year 1981.

Source: 1979/80 figures: *Interim Report of Government/CTU Working Party on Taxation*.

1980/81 figures: Revenue Commissioners.

Table 51

Family disposable income expressed as an index based on income of family dependent on average male industrial earnings

	1976/77	1977/78	1978/79	1979/80	1980/81
Senior management	214	206	201	203	246 (a)
Executive	127	123	123	121	124
Industrial worker	100	100	100	100	100
Unemployed	47	48	46	47	49

Notes: (See Appendix 1 for details of the families on which this table is based.)

(a) the substantial increase is due to the effects of income splitting for tax purposes which was introduced in the 1980 Budget and which was regressive.

Table 52

Family disposable income as % earned income

	1976/77	1977/78	1978/79	1979/80	1980/81
Senior management	%	%	%	%	%
Executive	62	64	64	60	67
Industrial worker	76	78	79	78	78
Unemployed	81	81	84	82	83
	—	—	—	—	—

Table 53

Recipients of income maintenance payments for the unemployed, week ending 27 June 1980

	Total	Unemployment benefit		Unemployment assistance
		Fiat rate	With pay-related benefit	
Recipients	86 602	24 418	19 856	42 328
Adult dependants	48 606 (a)	18 880	n.a.	19 726
Child dependants	95 246 (a)	41 167	n.a.	54 079

Note: (a) excluding dependants of recipients of pay-related benefit.

Source: Department of Social Welfare.

Table 54

Consumer prices, Ireland and UK, 1969-79

% change per annum (year-on-year)

	1970	1971	1972	1972	1972	1974	1975	1976	1977	1978	1979
UK	6.4	9.4	7.1	9.2	16.0	24.2	16.5	15.8	8.3	13.4	13.3
Ireland	8.2	8.9	8.7	11.4	17.0	20.9	18.0	13.6	7.6	13.3	13.3

Source: OECD, *Economic Outlook*, December (1980), p. 135.

Table 55

Consumer prices in the EEC, 1976-80

% change per annum (year-on-year)

	1977 (a)	1978 (a)	1979 (a)	1980
Germany	3.7	2.7	4.1	5.5
France	9.4	9.1	10.8	13.6
UK	15.8	8.3	13.4	18.4
Italy	18.4	12.1	14.8	21.2
Belgium	7.1	4.5	4.5	6.7
Denmark	11.1	10.0	9.6	12.3
Ireland	13.6	7.6	13.3	18.2
Luxembourg	6.7	3.1	4.5	6.2
Netherlands	6.4	4.1	4.2	6.5
EEC	9.9	7.0	8.9	12.2

Notes: (a) annual rates 1977, 1978, 1979 refer to year-on-year averages for calendar years.

Sources: 1977, 1978, 1979, OECD, *Economic Outlook*, December (1980), Table 24;

1980, OECD, *Main Economic Indicators*, March (1981), [p. 162-5]

Table 56

Demographic characteristics of EEC member states 1978—age distribution and dependency ratio

Per cent	Under 15 years (1)	15-64 years (2)	65 years + (3)	Dependency ratio (a) (4)
Belgium	20.9	64.9	14.2	54.1
Denmark	21.8	64.2	14.1	55.9
France	22.9	63.2	13.9	58.2
Germany	19.6	65.1	15.3	53.6
Italy	21.8	66.3	11.9	50.8
Luxembourg (b)	19.8	66.8	13.4	49.7
Netherlands	23.5	65.2	11.2	53.2
United Kingdom	22.0	63.5	14.5	57.5
Ireland (b)	31.4	57.8	10.8	73.0

Notes: (a) dependency ratio equals (1)+(3) as a percentage of (2)

(b) figures relate to 1977

Source: OECD, *Labour Force Statistics 1967-78*, Paris (1980).

APPENDIX 1

Ireland's foreign indebtedness—Some international comparisons¹

A 1.1 Throughout the present report, great stress has been laid on the magnitude of the balance of payments deficit, and the scale of Ireland's foreign indebtedness. The role of foreign borrowing in artificially maintaining living standards, preventing balance of payments adjustment, and producing a debt-servicing problem in future years has been made clear in Chapter 4. The purpose of this Appendix is to place Ireland's foreign indebtedness in a comparative context.

A 1.2 It is customary, in choosing countries as being appropriate for comparison with the Irish economy, to choose the member States of the European Community. This choice is more easy to justify on the basis of institutional links and data availability, than on any grounds suggested by output levels and economic structure. A choice based on the similarity of GNP *per capita* levels, the relative scale of the agricultural sector, the type of industrial structure and industrial policies would suggest a comparison between Ireland and such countries as Spain and Greece, or, alternatively, with the more affluent South-East Asian countries such as Hong Kong and Singapore. In particular, given that the scale of foreign borrowing is frequently defended on the grounds of Ireland's low GNP *per capita* relative to the other member States of the Community, it is of significant interest to compare Ireland's experience with countries at a similar GNP *per capita* level.

Comparison with other EEC Member States²

A 1.3 Ireland's official foreign indebtedness has increased at an extremeley rapid rate since 1978, with total official external debt increasing from Ir. £1.4 billion in December 1978 to Ir. £3 billion in December 1980, and a projected debt in excess of Ir. £4 billion by the end of 1981.³ However, even prior to this rapid increase

¹The comparisons made in the tables to the Appendix are, in the view of the Department of Finance, invalid to the extent that, in particular, (1) they relate only to Central Governments' debt position excluding what, for some countries, is an important and substantial private sector involvement in foreign currency borrowing and excluding also borrowing by State entities; some countries borrow heavily abroad through their State companies and very little in the name of the Central Government, and (2) they are based in some instances on inconsistent time periods e.g. the comparison between the Danish position in 1975 and the Irish position in 1978. It is the view of the Department that the comparative analysis of Ireland's foreign indebtedness in the Appendix does not, therefore, present a valid or realistic picture of Ireland's relative international position; for example in particular, the position vis-à-vis Denmark would need to be viewed with considerable caution.

²Due to data availability, Greece is discussed more fully in the following section.

³See 2.43.

ness position is more appropriately considered in comparison with the levels of indebtedness in other countries with similar levels of GDP *per capita*.

A 1.8 In comparing Ireland's indebtedness experience with that of other countries a number of measures can be used for comparison, each reflecting a different aspect of the indebtedness problem. First, official external debt *per capita* can be used, which provides some indication of the absolute burden of debt on citizens of different countries.⁵ Such a comparison is of particular use for countries with similar GDP *per capita* figures, although the measure is of less relevance for comparing countries with widely disparate income levels. Second, official external debt as a percentage of GDP provides an approximate measure of the relative burden of debt in different countries, in that it acts as an indicator for the share of national output devoted to the servicing of obligations to foreigners. (See footnote 1) The greater is official foreign indebtedness as a share of GDP, the smaller is the share of national output available to domestic residents, all other things being equal. Third, official external debt as a percentage of exports of goods and services provides some indication as to the capacity of the country in question to generate a sufficient amount of foreign exchange to enable effective servicing of the debt.

A 1.9 While external debt relative to gross exports of goods and services⁶ is frequently used as an indication of a country's capacity to finance its foreign debt, it is an incomplete indication which has only limited meaning when used for international comparisons.⁷ Firstly, exports of goods and services is a gross value measure, rather than a measure of value-added in the export sector, which is a more appropriate measure of 'true' exports. In a small open economy, such as Ireland, with limited internal linkages, and with the bulk of non-food exports produced by import-intensive transnational corporations, the ratio of net exports to gross exports is likely to be relatively low. As a consequence, the debt/exports ratio will understate the debt-payment burden relative to other countries. Secondly, many other factors affect the debt-servicing capacity of an economy, such as the stability and diversification of the export structure, the scope for low-cost import substitution, the size of foreign exchange reserves and the debt service record. Political factors, both as regards external alliances and internal stability, are also of importance. As regards some of these factors, Ireland's position is relatively good, most notably as regards the past debt service record, and consequently the debt/exports ratio may, in this regard, partly over-state the debt servicing problem relative to other countries. In conclusion, the debt/exports ratio must be used with caution, particularly in an Irish context.

A 1.10 The rapid growth in Ireland's official foreign indebtedness since 1978 is clearly indicated by movement in the three indicators of indebtedness discussed above. Foreign indebtedness *per capita*, increased from Ir. £420 in 1978 to Ir.

⁵ There is an implicit assumption here of foreign debt as a homogenous entity, with identical interest rates and repayment schedules in different countries. Although clearly a simplifying assumption, the measure gives a broad order of magnitude of the comparative burden of debt.

⁶ Alternatively, debt servicing payments relative to gross exports is used.

⁷ See World Bank, *Annual Report* (1980), Statistical Annex.

£885 in 1980.⁸ Official foreign indebtedness⁹ as a percentage of GDP increased from 22.2 per cent in 1978 to 35.7 per cent in 1980, and, on the basis of forecasts discussed in Chapter 2, in forecast to amount to 43 per cent of GDP at the end of 1981. Indebtedness as a percentage of exports of goods and services has moved in a similar manner, increasing from 41.3 per cent in 1978 to 64.1 per cent in 1980, and likely to be about 79 per cent of exports in 1981.

Table A 1.3
Ireland's official foreign indebtedness 1974-81

	(1) Debt <i>per capita</i> (Irish £)	(2) Debt as % GDP	(3) Debt as % exports of goods and services	(4) Debt <i>per</i> employed person (Irish £)	(5) Debt <i>per</i> employed person (Irish £; 1974 consumer prices)
		%	%		
March 1974	105	12.2	31.9	306	306
December 1978	420	22.2	41.3	1 249	712
December 1979	602	29.5	54.1	1 770	900
December 1980	885	35.7	64.1	2 610	1 122
December 1981 ^f	1 200	43	79	3 700	1 320

f = forecast

Notes: (a) converted at end-period exchange rates

(b) official indebtedness includes external debt of State-sponsored Bodies

(c) employment, population data are for April of particular year

Source: Central Bank of Ireland, QB, 2 (1975), 1 (1976), 1 (1980), 1 (1981)

Central Statistics Office

A 1.11 Given that the rapid increase in Ireland's indebtedness level has occurred primarily since 1978, it is unfortunate that the most recent comparative data available are for 1978. However, some indication of the movement in Ireland's indebtedness position relative to other countries can be obtained by examining the balance of payments deficits in the selected countries since 1978. The 1978 official indebtedness data, for all countries other than Ireland, was obtained from the 1980 *Annual Report* of the World Bank, while 1979 balance of payments data was extracted from the *International Financial Statistics Yearbook*, 1980.

A 1.12 The countries chosen for comparison can be divided into three groupings. The first grouping contains those countries with GDP *per capita* levels broadly similar to that of Ireland.¹⁰ The five countries selected are Greece, Spain, Singapore,

⁸ All indebtedness data refers to end-year figures.

⁹ Foreign indebtedness includes the external debt of the Exchequer and the State-sponsored bodies, but does not include the State-sponsored bodies foreign currency borrowing from Irish Banks. If such borrowing were included, external indebtedness relative to GDP would be 23.4 per cent in 1978 and 38.8 per cent in 1980, with a 1981 forecast of 46 per cent.

¹⁰ As estimated in *World Development Report*, (1979).

Israel and Hong Kong, all of which had a *GDP per capita* within 10 per cent of the Irish *GDP per capita* level.¹¹ The second grouping contains the other Newly Industrialising Countries, consisting of Yugoslavia, Portugal, Brazil, Taiwan, Mexico and South Korea. Finally, a third grouping contains a selection of other less developed countries, all with low *per capita* incomes.

Comparison with countries at similar level of development

A 1.13 A comparison of Ireland's foreign indebtedness with that of countries with similar *GDP per capita* levels reveals that, with the exception of Israel, Ireland's indebtedness *per capita* in 1978 was markedly greater than that of the other countries chosen (Table A 1.4). Ireland's debt *per capita* was twice as high as that of Greece, and over three times the level of indebtedness *per capita* in Spain and Hong Kong. Only Singapore, with official debt of \$579 *per capita*, was close to the \$855 figure for Ireland, Israel is best viewed as a special case, given the share of defence expenditure in GDP and its unique relationship with the United States.

Table A 1.4

Ireland's official foreign indebtedness
Comparison with countries at similar levels of development

	GNP per capita, 1977, US Dollars	External indebtedness: 1978		
		Dollars per capita	as % GDP	as % exports
Ireland	2 880	855	22.2	41.3
Spain	3 190	264	6.0	40.1
Singapore	2 880	579	16.6	10.0 (a)
Israel	2 850	2 663	79.1	160.8
Greece	2 810	420	12.2	73.1
Hong Kong	2 590	199	7/8 ^e	8.0 ^e

Notes: e estimate, relating 1978 indebtedness level to 1977 GDP, exports estimate is consequently a slight overestimate.

(a) assuming exports/GDP ratio in 1978 is the same as in 1977.

Source: Table 3:

World Development Report, (1979)

World Bank, Annual Report (1980)

IMF, International Financial Statistics Yearbook (1980)

A 1.14 As the selected countries all have similar *GDP per capita* levels, the ranking of countries on the criterion of indebtedness as a percentage of GDP is the same as for debt *per capita* with Ireland's debt burden being significantly greater than that of the other countries, with the exception of Israel. Debt levels relative to gross exports provide a slightly different picture, with the lower export orientation of the Greek economy resulting in Greece having a significantly larger debt/exports ratio than Ireland.

A 1.15 Some indication of the trends in indebtedness since 1978 is provided by

¹¹ Venezuela was excluded from this group, on the basis of it being a significant oil exporting country.

the magnitude of the deficit on current account of the balance of payments. A comparison of Ireland's balance of payments experience since 1979 with that of Greece and Spain provides strong evidence that Ireland's official indebtedness is increasing rapidly relative to these countries. According to OECD projections, Spain's current account deficit in the years 1979/81 is likely to average 1 per cent of GDP, with the corresponding figures for Greece being 5 per cent. Ireland's average payments deficit as a percentage of GDP over the same period is likely to be in excess of 10 per cent. The relative scale of foreign borrowing in the three countries is also suggested by the amount of central Government foreign borrowing in 1979 which amounted to 0.1 per cent of GDP in Spain, 1.5 per cent of GDP in Greece and 6.4 per cent of GDP in Ireland (Table A 1.5).

A 1.16 As regards Ireland's position *vis-a-vis* the other three countries, Israel's central Government borrowing in 1978 was substantially greater than that of Ireland, although the current account deficit relative to GDP was smaller. Singapore's current account deficit in 1979 was extremely large, and must have entailed significant recourse to official external borrowing.

A 1.17 In conclusion, Ireland's indebtedness level, even in 1978, was relatively high in comparison with countries at similar levels of economic development. Only in Israel was the burden of the official foreign debt, both in relative and absolute terms, greater than in Ireland. Trends since 1978 suggest that this ranking of countries is unlikely to have changed. With regard to Spain and Greece, it is clear that Ireland's debt level has increased significantly relative to these countries since 1978. Taking the official external debt as a percentage of gross exports of goods and services as an approximate indicator of the debt servicing burden, Ireland's ranking improves somewhat, at least relative to Greece.

Comparison with lower income countries

A 1.18 Further insight into Ireland's indebtedness level can be obtained from comparing Ireland's debt level with those of substantially poorer countries. Examining firstly those Newly Industrialising Countries (NIC's) not included in Table A 1.4, Ireland's debt level *per capita* in 1978 was higher than any of the six countries included here (Table A 1.1). Furthermore, with the exception of South Korea and Mexico, Ireland's debt relative to GDP is as high or higher than that of these poorer countries. Ireland's balance of payments deficit on current account in 1979 was also significantly larger relative to GDP than in Portugal, South Korea, Mexico and Brazil, the four countries for which data are available (Table A 1.6). As noted previously, given the primary role of official foreign borrowing in financing Ireland's balance of payments deficit, the balance of payments data suggest that Ireland is increasing its foreign indebtedness at a significantly faster rate than these four countries. It is noteworthy that the foreign indebtedness level forecast for Ireland in 1981, at 43 per cent of GDP, is greater than any of the debt levels recorded in the poorer NIC's in 1978.

A 1.19 While Ireland's debt/GDP level is higher than four of the poorer NIC's in 1978, the relatively high gross exports/GDP ratio of the Irish economy ensures that Ireland's debt/exports ratio is lower than any of the poorer NIC's with the

Table A 1.5

Trends in indebtedness

	Balance of payments, 1979		Central Government 1979 Foreign borrowing as % GDP
	Current account deficit as % GDP		
	%		%
Ireland	10.1		6.4
Spain	-0.6		0.1
Singapore	13.1		n.a.
Israel	8.3		10.5
Greece	4.9		1.5
Hong Kong	n.a.		n.a.

(1)

	Balance of Payments Deficit on Current Account, as % GDP			
	1979		1980 ^e	
	%		%	
Greece	5		5	5
Spain	-1		2	2
Ireland	10		8	14

(2)

Sources: (1) *International Financial Statistics Yearbook* (1980)
(2) *OECD Economic Outlook* December (1980)

exception of Taiwan. While Ireland's debt-exports ratio is likely to increase from 41 per cent to 79 per cent between 1978 and 1981, it seems likely that, even allowing for the qualifications discussed in paragraph A 1.9, the burden of indebtedness on the balance of payments is lower in Ireland at present than in the poorer NIC's with the exception of Taiwan and, possibly, Yugoslavia.

A 1.20 A comparison of Ireland's debt levels with some very poor countries is also contained in Table A 1.6. While the absolute level of debt *per capita* is relatively small in these countries, the low levels of output and exports *per capita* have resulted in very high debt/exports ratios, most notably in the case of Pakistan.

Qualifications

A 1.21 While the data presented above provide a useful preliminary examination of Ireland's foreign indebtedness position relative to that of other countries, a number of important qualifications must be stressed. The above discussion has referred throughout to the level of official foreign indebtedness, without regard to the level of official external reserves. It might be argued that a more appropriate measure would be the net external liabilities of the public authorities—that is, the level of official foreign indebtedness less the level of official external reserves.

It is noteworthy that the increase in the net external liabilities of the public authorities in Ireland since December 1978 has been remarkable, with net liabilities of approximately £150 million in December 1978 increasing to over £1.6 billion in December 1980, with a further increase of about £1.2 billion forecast during 1981.

A 1.22 While relating the level of foreign indebtedness to the size of population, GDP and exports provides some indication as to the main features of one country's indebtedness problem relative to another, it is important to stress that the measures used above are extremely crude. For example, the interest burden of foreign debt is, of course, dependent upon the interest-rates and maturity structure of the debt in addition to the absolute level of the debt. The influence of differing interest rates and maturity dates in comparing debt levels is likely to be particularly important where a country is the recipient of substantial "soft" loans, arising from close political linkages with a major creditor. Among the countries where this is likely to be of importance are Israel and South Korea.

Conclusions

A 1.23 The primary conclusions derived from these international comparisons of the levels of official foreign indebtedness in selected countries are:

- (i) Ireland's level of foreign indebtedness is extremely high in comparison with the more affluent members of the European Community
- (ii) Ireland's level of foreign indebtedness is high in comparison with countries with countries of a similar level of economic development. It seems clear from balance of payments evidence that Ireland's foreign debt is also increasing at a faster rate than in these countries since 1978
- (iii) comparison of Ireland's official foreign debt with that of the poorer newly industrialising countries reveals that both the relative and absolute burden of foreign debt is somewhat greater in Ireland than in four of the six poorer newly industrialising countries
- (iv) Ireland's debt level relative to gross exports is lower than would be expected on the basis of the debt/GDP ratio. The higher export/GDP ratio suggests that a country can more easily finance a given volume of debt relative to GDP, although the high export/GDP ratio may be partly attributable to a low value-added/final sales ratio relative to larger economies with greater internal linkages
- (v) while the cross-sectional data above provided some insight into the scale of Ireland's foreign debt, the most notable feature concerning the level of official external indebtedness has been its rapid rate of growth, as indicated in Table A 1.3. Official foreign indebtedness amounted to 12.2 per cent of GDP in 1974, 22.2 per cent in 1978, 35.7 per cent in 1980, and a forecast figure of 43 per cent in 1981.

Table A 1.6

Official foreign indebtedness
Comparison with lower income countries

	GNP per capita 1977, US Dollars	Official external indebtedness 1978			Current account deficit as % GDP 1979
		\$ per	as % GDP	as % Exports	
IRELAND	2 880	855	22.2	41.3	10.1
<i>Other newly industrialising countries</i>					
Yugoslavia	1 960	209	11.0	65.9	n.a.
Portugal	1 890	330	19.0	95.3	-0.7
Brazil	1 360	289	20.5	288	5.1
Taiwan	1 170	259	22.0 ^e	40 ^e	n.a.
Mexico	1 120	466	33.7	310	3.8
South Korea	820	493	38.3	114	6.9
<i>Selected other countries</i>					
Philippines	450	163	32	176	
Indonesia	300	130	54	260	
Pakistan	190	129	57	587	
India	150	32	19	244	

Note: e is estimated as in Table A 1.4

Source: as Table A 1.4

APPENDIX 2

The Existing Usage of Ireland's Foreign Borrowing

A 2.1 The balance of payments deficit on current account equals the difference between domestic expenditure on goods and services and Gross National Disposable Income. In the National Accounting terms domestic expenditure on goods and services equals the sum of private consumption expenditure, public consumption expenditure, and investment expenditure, while Gross National Disposable Income (GNDI) equal Gross National Product (GNP) plus net transfers from abroad.

Table A 2.1 below illustrates the movements of domestic incomes and expenditure in the period 1977-80, with a forecast for 1981. As can be seen, domestic expenditure has risen relative to GNDI in recent years and the excess of expenditure over GNDI could amount to 13.2 per cent of GNDI in 1980.

Table A 2.1

Expenditure, incomes and the deficit on current account, 1977-81

£ million	1977	1978	1979	1980	1981 ^f
(1) Gross National Disposable Income	5 659.1	6 683	7 735	8 855	10 405
(2) Balance of payments deficit on current account	155.2	148.8	670	700	1 375
(3) Domestic expenditure	5 814.3	6 831.8	8 405	9 555	11 780
(4) (2) as a % of (1)	2.7%	2.2%	8.7%	7.9%	13.2%

Note: Data used are subject to qualifications noted in ERO, Summer (1981), Table 1, and derived from Tables 1-4. 1979 GNDI and Deficit figures are adjusted to allow for reclassification of EMS capital transfers.

Source: ERO, Summer (1981):

Chapter 2.

A 2.2 Given that the current account deficit is equal to the difference between domestic expenditure and domestic incomes, it must be financed by external borrowing of some form. The external current account deficit can be financed by any of: (a) borrowing abroad by the non-bank private sector, (b) external borrowing of the commercial banks, (c) increased net borrowing by the public sector. Net external borrowing of the public sector can occur through Exchequer borrowing abroad, State-sponsored bodies borrowing abroad or a decrease in official external reserves.¹ In recent years, Ireland's deficit on current account has been financed

¹ Movements in official external reserves can also arise due to revaluation effects of exchange rate movements.

APPENDIX 3

Current Budget 1981-84

This Appendix explores some broad orders of magnitude for the current budget over the three-year period 1981-84. These are not forecasts, but explorations of the outcome under two possible growth rates of Gross Domestic Product, given a 'neutral' Budget in each year. The two alternative growth rates are:

- 2.5% per annum over the three-year period 1981-84
- 4.5% per annum over 1981-84.

The type of 'neutral' Budget which is assumed in each of the three years is as follows:

- no change in the volume of Government current or capital expenditure
- specific rates of indirect taxation rising by the same proportion as consumer prices
- personal income tax allowances rising by the same proportion as consumer prices.

No assumption is made about increasing the rate bands for income taxation in line with the rate of price inflation—one form of 'neutral' Budget would include such an assumption.

The overall rate of price inflation (i.e. the GDP deflator) is taken to be 10 per cent per annum. Plausible assumptions are made about the growth of the individual revenue items in response to changes in rates of tax, in real output and in prices. The components of revenue and their respective chosen determinants are given in Table A 3.1.

Details on the coefficients, which link each item of revenue to each of its determinants, are in a note which is available from the secretariat.

The following are the details assumptions which are made:

- that specific excise duties rise in line with the rate of price inflation
- that no change occurs in the effective rate of excise duty on motor vehicles, nor in rates of value-added tax
- that real personal consumer expenditure, and real consumption of durables grow in line with real GDP

DIAGRAM A 2.1

SOURCE AND USE OF INVESTIBLE FUNDS 1977-1980

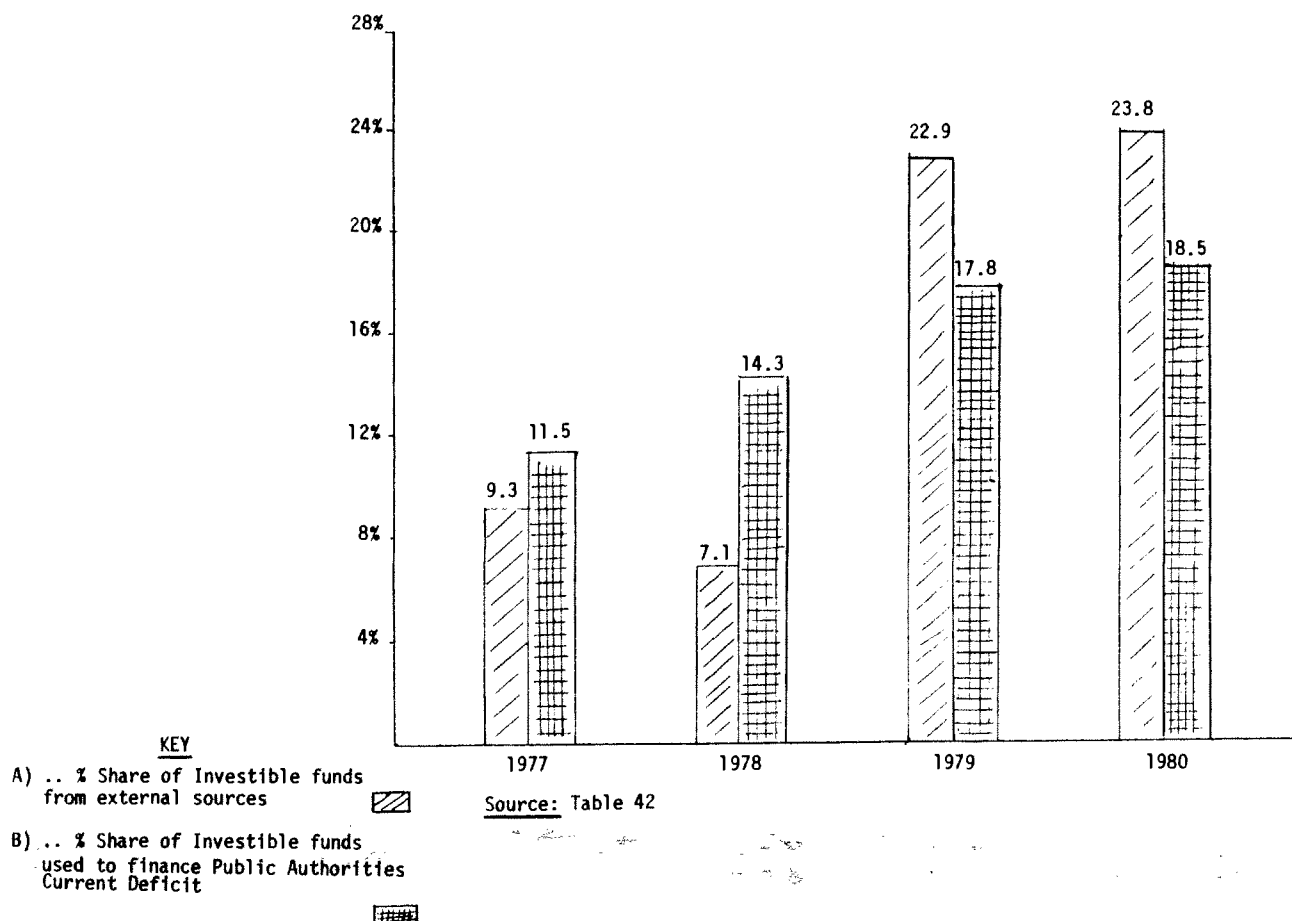


Table A 3.1

Components of revenue and their determinants

Components	Determinants
Tax revenue Excise duties, other than on cars	Rates of specific excise duties; price index for personal assumptions; real personal consumer expenditure
Excise duties on motor vehicles	Effective rate of duty (<i>ad valorem</i>); price index for personal consumption of durables; real consumption of durables
Income tax	Taxable income; personal allowances potentially claimable by those in the tax net
Value-added tax	Weighted average of VAT rates; tax base at constant prices; price index for personal consumption
Motor vehicle duties	Weighted average of road tax on private cars; ideal personal consumer expenditure
Other tax revenue	Nominal GDP
Non-tax revenue	Nominal GDP

- that the price indices for both personal consumption, and for personal consumption of durables, rise in line with the price index of GDP
- that nominal taxable income (for personal income taxation) grows in line with nominal GDP
- that personal income tax allowances are increased by the same proportion as the relative rise in prices
- that the VAT tax base, at constant prices, rises in line with real GDP. (This tax base is, strictly speaking, a weighted average of the current and the previous year's consumption and tourism expenditure: this complication is ignored).

On the revenue side, there is an allowance for the fact that the 1981 estimate for "other tax" revenue includes non-recurring receipts of £66 million from bringing forward the payment date for the second instalment of Corporation Tax. The estimate of non-tax revenue in 1981 includes an estimated £32 million of delayed Post Office revenue which will not be available in 1984. Moreover, EMS interest subsidies of £45 million in 1981 will not be available in 1984. The 1981 base for the calculations is adjusted for both of these elements.

On the expenditure side, to obtain the service of the public debt, the Exchequer Borrowing Requirement is assumed to grow in line with price inflation in the

period 1981-84. A nominal interest rate of 12 per cent is assumed for new borrowings. Expenditure on social welfare payments are assumed to grow in line with price inflation. In the case where an average annual increase of 2.5 per cent in the volume of output is assumed, expenditure on social welfare payments is likely to be understated. This is because such a growth rate is likely to lead to some increase in unemployment, with a consequent rise in expenditure on unemployment assistance and pay-related benefit.

The volume of other Government current expenditure is assumed to remain at its 1981 level. If this volume of expenditure were converted to nominal values by using the price index for GDP, there would be an under-estimate of current expenditure. The average cost of Government goods and services has tended to rise at a faster rate than the average cost of all commodities. Hence, the implicit price of Government current expenditure is obtained by combining the GDP deflator with a "relative price effect", i.e. the rise in the average cost of Government goods and services relative to the average cost of other goods and services. In the period 1975-79, the relative price effect (measured by the implicit price deflator for net expenditure by public authorities on current goods and services, relative to the GDP deflator) was 1.8 per cent per annum, on average. This relative price effect is used for the 1981-84 period.

The projections for the current Budget are in Table A 3.2. The revised estimate for the 1981 Budget deficit, given in the July Budget, is £787 m. With an assumption of a growth rate of 2.5 per cent per annum in real output, the Budget deficit rises to £1,405 m in 1984. The deficit would be 10.0 per cent of GNP in 1984, higher than the proportion of 7.9 per cent in 1981. (In calculating this proportion, the average annual growth rate for GNP, corresponding to the assumed growth rate of GDP, is taken to be 2 per cent a year).

The next question which is addressed is the extent to which a higher growth of real output, if achieved, would by itself lead to a lower current Budget deficit. The deficit would be expected to be lower, for a number of reasons. Since real personal consumer expenditure would be higher, there would be greater receipts from excise duties. For the same reason, there would be higher receipts from value-added tax, and from motor vehicle duties. Since taxable income (in nominal terms) would be higher, income tax receipts would be higher. Other tax revenue, and non-tax revenue (which are assumed to grow in line with nominal GDP) would be higher. All of these effects are allowed for, and the resulting revenue projections are in Table A 3.2. With a growth of output of 4.5 per cent a year, total revenue in 1984 would be £6,009 m, compared with £5,599 m with a growth rate of 2.5 per cent.

On the expenditure side, a higher growth rate would lead to lower current expenditure on unemployment assistance, and on pay-related benefit. Bearing in mind the link between output and employment, and the fact that an increase of (say) 100 in employment does not lead to a reduction in unemployment of 100¹, the higher growth rate could lead to unemployment (numbers on the Live

¹Colm McCarthy, "The Impact of Job Creation on Unemployment and Emigration", Central Bank of Ireland, *Quarterly Bulletin*, Summer (1979).

Register) being 9 per cent lower in 1984 (calendar year average). This would lead to payments for unemployment assistance together with those for pay-related benefit being some 8 per cent lower. The result would be lower expenditure by £9 m.

The result would be a Budget deficit of £986 m in 1984, or 6.7 per cent of the (higher) GNP in that year. (In calculating this proportion, the average annual growth rate for GNP is taken to be 4 per cent a year). This would be only slightly lower than the proportion of 7.9 per cent in 1981.

Table A 3.2
Projections of current budget 1981-84

£m			
	1981 revised estimate after July budget	Projected 1984	
		with 2.5% growth in output	with 4.5% growth in output
<i>Receipts</i>			
Tax revenue:			
Excise	1 077	1 519	1 581
Income tax	1 191	1 843	2 031
Value-added tax	601	926	1 008
Motor vehicle duties	43	54	57
Other	368	433	459
Total	3 280	4 775	5 136
Non-tax revenue	652	824	873
Total	3 932	5 599	6 009
<i>Expenditure</i>			
Service of Public Debt	1 004	1 830	1 830
Social Welfare expenditure	588	783	774
All other expenditure	3 127	4 391	4 391
Total	4 719	7 004	6 995
<i>Deficit</i>	787	1405	986

£m

APPENDIX 4

Direct Taxes and Transfers and their effects on Proto-Type Families

1. In a previous report,¹ the Council examined the distributive impact of taxes and transfers on nine proto-type families. Subsequently official estimates of these distributive effects in 1973 were published.² The importance of such estimates for social policy development was discussed in Chapter 3 of this report.
2. In this appendix, the effects of direct taxes (including social insurance contributions) and transfers on a limited number of proto-typical families in recent years are examined. The effects of indirect taxes and benefits of kind are not included and so this analysis is a partial review of the effects of the tax/transfer system.
3. Each of the families, with the exception of the contributory pensioners, is assumed to have two children in respect of whom children's allowances are payable. No tax allowances, other than personal allowances, are assumed. The examples are not directly comparable with those used in NESC Report No. 11. The families are as follows:
 - A. Senior Management; the IMI survey of management earnings are used
 - B. Executive; for which civil service salary scales are used but with standard rates of social insurance contributions
 - C. average male industrial earnings; for which CSO data are used, with estimates for 1980/81
 - D. unemployment for which unemployment benefit rates are used, on the assumption that no pay-related benefit is received
 - E. old age pension; for which contributory pension rates (under 80) are used with the assumption that there is an adult dependent aged under 67.

¹ NESC Report No. 11, *Report on Income Distribution*. (Dublin, 1975).

² CSO, *Distributive Impact of State Tax and Benefits on Household Incomes in 1973*.

	A	B	C	D	E
Earned income	9 811	4 727	3 483	—	—
Less income tax	3 635	1 034	556	—	31
Less social insurance	160	160	160	—	—
Income after direct taxes	6 016	3 533	2 767	—	—
As % earned income	61%	75%	79%	—	—
Plus benefits in cash	71	71	71	1 329	1 128
Disposable income	6 087	3 604	2 838	1 329	1 097
As % earned income	62%	76%	81%	—	—

1977-78

Earned income	10 401	5 130	3 988	—	—
Less income tax	3 629	1 045	645	—	—
Less social insurance	174	174	174	—	—
Income after direct taxes	6 598	3 911	3 169	—	—
As % earned income	61%	76%	79%	—	—
Plus benefits in cash	75	75	75	1 548	1 287
Disposable income	6 673	3 986	3 244	1 548	1 287
As % earned income	64%	78%	81%	—	—

1978-79

Earned income	11 956	5 863	4 546	—	—
Less income tax	4 184	1 081	620	—	—
Less social insurance	203	203	203	—	—
Income after direct taxes	7 569	4 579	3 723	—	—
As % earned income	63%	78%	82%	—	—
Plus benefits in cash	77	77	77	1 740	1 444
Disposable income	7 646	4 656	3 800	1 740	1 444
As % earned income	64%	79%	84%	—	—

1979-80

Earned income	14 692	6 696	5 259	—	—
Less income tax	5 756	1 301	798	—	—
Less social insurance	242	242	231	—	—
Income after direct taxes	8 694	5 153	4 230	—	—
As % earned income	59%	77%	80%	—	—
Plus benefits in cash	100	100	100	2 017	1 726
Disposable income	8 794	5 253	4 330	2 017	1 726
As % earned income	60%	78%	82%	—	—

1980-81

Earned income	18 619	8 042	6 082 (e)	—	—
Less income tax	5 980	1 558	872	—	—
Less social insurance	315	315	274	—	—
Income after direct taxes	12 324	6 169	4 936	—	—
As % earned income	66%	77%	81%	—	—
Plus benefits in cash	131	131	131	2 500	2 217
Disposable income	12 455	6 300	5 067	2 500	2 217
As % earned income	67%	78%	83%	—	—

APPENDIX 5

Note of Dissent by ICTU representatives

The ICTU representatives emphatically reject the recommendation for a so-called "incomes pause" (in reality, a pay pause) of eighteen months as unacceptable, impracticable, inappropriate and discriminatory. It would involve a massive cut in workers' living standards.

It is a ridiculous delusion to expect workers to forego any increase in pay over such a long period in the light of the sharp increases in prices that have already occurred and which are likely over the coming months. When prices are rising at an annual rate of over 20% with little prospect of any significant moderation in the rate of price inflation, the only protection for workers' living standards lies in a substantial increase in pay to meet these price increases. In these circumstances workers would, quite rightly, deride any suggestion of such a pay pause. The Council's proposal must, therefore, be regarded as completely unrealistic.

Such a pay pause would be impracticable if only because of its unacceptability to workers. Any attempt by whatever means to impose it would meet with such resistance as to bring about an unprecedented upheaval in industrial relations.

A pay pause such as the Council proposes would be inappropriate as its deflationary impact would have catastrophic effects on demand for home-produced goods and services leading to an upsurge in the already intolerably high level of unemployment. If, by some unimaginable sequence of events such a deflation did resolve the problem of inflation, the consequences for the economy would be such that the cure would be worse than the disease.

Since, in practice, the pause would apply only to wages and salaries, it would be discriminatory.

The Congress representatives find it difficult to credit that members of the Council could subscribe to so far-fetched and unrealistic a proposal. Whatever label may be put on it, its consequence would be such as to make the most extreme monetarist approach appear progressive.

We see no point in analysing in detail the implications of the proposal or its impracticability but would, however, make the following points:

- It is proposed that farm incomes would be excluded from the "incomes" pause. Individual farmers, irrespective of the amount of the increase in income that they might secure, would be exempt, while the most lowly-paid workers would be prevented from getting any increase in pay.
- The application of an incomes pause to the self-employed would, for all practical purposes, be impossible.
- The inclusion of dividend income would be meaningless as the distribution of increased profits would simply be deferred or would subsequently

accrue as capital gains.

- (d) Management salaries, bonuses and benefits could not effectively be included in any pause.
- (e) The National Prices Commission would not be in a position to ensure, as is suggested, that price increases intended to compensate for increases in income would not be granted. There is nothing that the NPC could do to effect anything equivalent to a prices freeze nor indeed could it do anything at all to control certain prices including professional fees.

In addition, Congress representatives would draw attention to the following incontrovertible facts:

- (1) Average hourly wages, and particularly, average hourly labour costs, in Irish industry are the lowest in the EEC.
- (2) Industrial workers in Ireland have a longer working year than workers in any other EEC country.
- (3) Scores of thousands of workers are at present in receipt of basic wages of under £70 a week.
- (4) Price is one factor only, and in the case of many products, not necessarily the most significant factor, in competitiveness. This is particularly so in the case of competing imports.
- (5) A leading US industrialist has very recently pointed out that a major consideration in deciding to locate a new plant in Ireland was the low level of wages.

The Congress representatives concur with the statement in Paragraph 4.40 that a "moderation in the growth of real incomes" would provide a significant stimulus to employment growth, even in the short term. We would point out that trade unions are striving merely to maintain the real incomes of their members.

17 September 1981

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NOTE: The date on the front cover of the report refers to the date the report was submitted to the Government. The dates listed here are the dates of publication.

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